

**Volume 19**

**Print ISSN: 1087-8955**

**Online ISSN: 1939-4667**

# **ENTREPRENEURIAL EXECUTIVE**

**Martin Bressler**

**Editor**

**Southeastern Oklahoma State University**

**An official journal of the  
Academy of Entrepreneurship®**

The *Entrepreneurial Executive* is owned and published by Jordan Whitney Enterprises, Inc. Editorial content is under the control of the Academy of Entrepreneurship, Inc., a non-profit association of scholars, whose purpose is to support and encourage research and the sharing and exchange of ideas and insights throughout the world.

Authors execute a publication permission agreement and assume all liabilities. Neither Jordan Whitney Enterprises nor Academy of Entrepreneurship is responsible for the content of the individual manuscripts. Any omissions or errors are the sole responsibility of the authors. The Editorial Board is responsible for the selection of manuscripts for publication from among those submitted for consideration. The Publishers accept final manuscripts in digital form and make adjustments solely for the purposes of pagination and organization.

The *Entrepreneurial Executive* is owned and published by Jordan Whitney Enterprises, Inc. PO Box 1032, Weaverville, NC 28787, USA. Those interested in communicating with the *Journal*, should contact the Executive Director of the Allied Academies at [info@alliedacademies.org](mailto:info@alliedacademies.org).

Copyright 2014 by Jordan Whitney Enterprises, Inc., USA

## EDITORIAL BOARD MEMBERS

Paul Allen  
Mississippi State University, Meridan

Ismet Anitsal  
Tennessee Tech University

Stephen Betts  
William Patterson University

Thomas J. Boyle  
Seton Hall University

Kent Byus  
Texas A&M University – Corpus Christi

Kitty Campbell  
Southeastern Oklahoma State University

Shawn M. Carraher  
Indiana Wesleyan University

Sanjib Chowdhury  
Eastern Michigan University

Colin K. Drummond  
Case Western Reserve University

Arthur K. Fischer  
Pittsburg State University

Daniel Glaser-Segura  
Our Lady of the Lake University

Abdalla Hagen  
Grambling State University

Kirk Heriot  
Columbus State University

Robert J. Hockin  
Capella University

William T. Jackson  
University of South Florida-St. Petersburg

Norris F. Krueger, Jr.  
Boise State University

Kenneth J. Lacho  
University of New Orleans

William Laing  
Anderson University

Joe Aniello  
Francis Marion University

Stephanie Bardwell  
Christopher Newport University

Thomas Box  
Pittsburg State University

Martin Bressler  
Southeastern Oklahoma State University

James W. Cagley  
University of Tulsa

Samuel Cappel  
Southeastern Louisiana University

Raman Chadha  
DePaul University

Jo Ann M. Duffy  
Sam Houston State University

Kevin Ennis  
Mississippi State University

R. Ganesan  
Indian Institute of Technology Delhi

Robert D. Gulbro  
Athens State University

Michael Harris  
Eastern Michigan University

William Hill  
Mississippi State University, Meridan

Mark Hoelscher  
Illinois State University

Doh-Khul Kim  
Mississippi State University, Meridan

Jayesh Kumar  
Xavier Institute of Management

James Lawson  
Mississippi State University

Jonathan Lee  
University of Windsor, Ontario

## EDITORIAL BOARD MEMBERS

Deanna Mader  
Marshall University

Marjorie McInerney  
Marshall University

Jens Mueller  
Waikato Management School, New Zealand

Gbadebo Olusegun Odularu  
Covenant University

John A. Parnell  
University of North Carolina at Pembroke

William David Perkins  
Abilene Christian University

Steven E. Phelan  
University of Nevada, Las Vegas

Don Pope  
Abilene Christian University

Richard David Ramsey  
Southeastern Louisiana University

Gerald J. Segal  
Florida Gulf Coast University

Linda Shonesy  
Athens State University

Olin Scott Stovall  
Abilene Christian University

Thomas Straub  
University of Geneva

Shane Tomblin  
Marshall University

Phil Vardiman  
Abilene Christian University

Avinash Waiker  
Southeastern Louisiana University

Rick J. Weible  
Marshall University

Paul G. Wilhelm  
Cameron University

Kenneth K. Mitchell  
Shaw University

Deependra Moitra  
Lucent Technologies

John D. Neill III  
Abilene Christian University

Donatus Okhomina  
Alabama State University

David P. Paul, III  
Monmouth University

Terry Pearson  
West Texas A&M University

Keramat Poorsoltan  
Frostburg State University

Tom Pressly  
Penn State University - Shenango Campus

Sujata Satapathy  
Indian Institute of Technology Delhi

SuengJae Shin  
Mississippi State University

William L. Smith  
Emporia State University

Charles R. B. Stowe  
Lander University

Uday Tate  
Marshall University

Rodney C. Vandever  
Purdue University

George S. Vozikis  
California State University, Fresno

V. P. Wani  
National Institute of Technology

Terry Wiant  
Marshall University

Brian P. Winrow  
Winona State University

## **EDITORIAL BOARD MEMBERS**

Joanna Marie Wolek  
University of Illinois at Chicago

Tom Wright  
University of Nevada, Reno

John W. Yeargain  
Southeastern Louisiana University

David Wright  
Abilene Christian University

David Wyld  
Southeastern Louisiana University

## TABLE OF CONTENTS

EDITORIAL BOARD MEMBERS.....	III
LETTER FROM THE EDITOR.....	IX
VIRAL MARKETING: TECHNIQUES AND IMPLEMENTATION.....	1
Brandon Rollins, Tennessee Tech University	
Ismet Anitsal, Tennessee Tech University	
M. Meral Anitsal, Tennessee Tech University	
COVERED IN OIL – AGAIN.....	19
Louis C. Mancuso, Southern University at New Orleans	
Biruk Alemayehu, Southern University at New Orleans	
Marjorie Anne Fox, Southern University at New Orleans	
H. Kevin Fulk, Southern University at New Orleans	
CLOUD COMPUTING EFFECTS ON SMALL BUSINESS.....	35
Ghasem S. Alijani, Southern University at New Orleans	
H. Kevin Fulk, Southern University at New Orleans	
Adnan Omar, Southern University at New Orleans	
Rohit Tulsi, Southern University at New Orleans	
A COMPARATIVE STUDY OF ENTREPRENEURIAL COMPETENCIES OF SMALL BUSINESS’ OWNERS IN THE UPPER PENINSULA OF MICHIGAN, USA AND COMPANIES WINNING THE TOP PRIZE IN BRAZIL .....	47
Ana Alice Vilas Boas, The Federal University of Lavras, Brazil	
Tania Regina Frota Vasconcellos Dias, The Federal Rural University of Rio de Janeiro	
Raymond Amtmann, Northern Michigan University	
FAMILY BUSINESS SUCCESSION: HOW MEN AND WOMEN PREDECESSORS CAN BRING CREDIBILITY TO THEIR SUCCESSORS?.....	67
Vivi Koffi, University of Moncton	
Izold Guihur, University of Moncton	
Tania Morris, University of Moncton	
Gérard Fillion, University of Moncton	

CLOUD COMPUTING’S SELECTION AND EFFECT ON SMALL BUSINESS .....	87
Don B. Bradley III, University of Central Arkansas	
Joel Cooper, University of Central Arkansas	
CROWDFUNDING: A NEW OPPORTUNITY FOR SMALL BUSINESS AND ENTREPRENEURSHIP .....	95
Don B. Bradley III, University of Central Arkansas	
Charles Luong, University of Central Arkansas	
NEW MENU LABELING REQUIREMENTS FOR RETAIL FOOD CHAINS: POSSIBLE IMPACT ON SMALL BUSINESS RESTAURANTS.....	105
Dawn Langkamp Bolton, Western Kentucky University	
FAMILY BUSINESS SUCCESSION: WHAT ARE THE WAYS USED BY THE MEN BUSINESS MANAGERS TO LEGITIMIZE THEIR SUCCESSORS?.....	111
Vivi Koffi, University of Moncton	
Gérard Fillion, University of Moncton	
Jean-Pierre Booto Ekionea, University of Moncton	
Tania Morris, University of Moncton	
SMALL BUSINESS AND OBAMACARE: THE NEW LAW’S RULES <u>DO APPLY</u> “TO THE VAST MAJORITY OF ALL BUSINESSES” .....	131
Robert J. Lahm, Jr., Western Carolina University	
ACTIVITY BASED COSTING IN SERVICES INDUSTRY: A CONCEPTUAL FRAMEWORK FOR ENTREPRENEURS .....	149
Osman Kursat Onat, Mehmet Akif Ersoy University	
Ismet Anitsal, Tennessee Tech University	
M. Meral Anitsal, Tennessee Tech University	
HELPING SMALL BUSINESS ENTREPRENEURS AVOID CRITICAL MISTAKES IN QUICKBOOKS ACCOUNTING SOFTWARE .....	169
Andrew Schiff, Towson University	
Joseph Szendi, Towson University	

USING SOCIAL NETWORKS TO BUILD BUSINESS CONNECTIONS:  
ENGAGEMENT AND INTERACTIVITY ON GUAM'S RESTAURANTS'  
FACEBOOK PAGES ..... 183  
    Lilnabeth P. Somera, University of Guam

FIXING THE TAX GAP: ELECTRONIC MEANS FOR THE INTERNAL REVENUE  
SERVICE TO EMBRACE ..... 195  
    Edwin J. Wu



## LETTER FROM THE EDITOR

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

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

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

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

Martin Bressler  
Southeastern Oklahoma State University



# VIRAL MARKETING: TECHNIQUES AND IMPLEMENTATION

**Brandon Rollins, Tennessee Tech University**  
**Ismet Anitsal, Tennessee Tech University**  
**M. Meral Anitsal, Tennessee Tech University**

## ABSTRACT

*Viral marketing is a form of marketing that occurs when buzz marketing generates word-of-mouth communication among consumers, particularly on the Internet. Viral marketing has become increasingly relevant over the last decade with the uprising of social media networks such as Facebook, Twitter, and YouTube. Small and large companies alike have used viral marketing techniques to promote a wide variety of products. Online viral marketing is still very much in its infancy. The objective of this research is to investigate viral marketing, from both business and consumer perspectives. More specifically, an analysis of the fundamental principles behind viral marketing is used to create an overview of the advantages and disadvantages of attempting a full-scale viral marketing campaign, leading several important propositions. This analysis of viral marketing also offers a conceptual model. The paper concludes with implications for researchers and managers.*

## INTRODUCTION

Marketing messages have become a pivotal and inseparable part of society. Decades of listening to similar business-to-consumer messages have made consumers inattentive and skeptical about advertisements. The advent of new media via the Internet has allowed businesses to change their advertising methods to be more suitable for emerging trends in consumer behavior such as sharing through social media. Instant communication has provided consumers with a way to communicate directly with businesses, therefore allowing for two-way communication. Many corporations, including large ones such as Old Spice, Levi Strauss, Nike, Chevrolet, and Burger King have taken advantage of viral marketing by providing unusual, mold-breaking advertisements that have generated buzz by interacting with or entertaining consumers.

An effective way to raise interest in a company's products and services is to stimulate word-of-mouth communication among the company's prospective target market (Palka 2009). As friends and acquaintances exchange product recommendations, word-of-mouth becomes a powerful vehicle for generating buzz, boosting sales revenues, increasing market share, and building a commendable reputation (Emakina 2007). Word-of-mouth can also stifle the progress

of a company, if the goods or services provided consistently disappoint consumers (Dufour 2011). This places additional importance on the customer's perception of quality and value in a company's products and services in terms of customer satisfaction since both bad and good reviews spread quickly through recommendation networks (Leskovec 2007).

The popularity of the Internet, social media, and mobile computing has provided a new conduit for word-of-mouth. The Internet removes many of the communication barriers that lie between people such as distance, time of day, and culture. As a consequence, sharing information is more open than ever before (Leskovec 2007). This unhindered form of online word-of-mouth that has arisen with the advent of the Internet, is often termed viral marketing (Palka 2009). Viral marketing can promote the exponential spread of marketing messages to niche segments on a scale unparalleled by even multimillion dollar traditional marketing campaigns (Leskovec 2007).

Viral marketing campaigns can be unpredictable because it relies on the reception and interpretation of marketing messages by consumers (Dufour 2011). Viral marketing, unlike television marketing, radio marketing, billboards, or fliers, requires on direct consumer input (Phelps 2004). Traditional marketing allows consumers to passively consume messages, whereas viral marketing relies on consumers who are willing to take an active part in spreading a message (Stonedahl 2010). When videos, images, and phrases become popular on the Internet, they are said to go "viral" (Sexton 2011). The same semantic principle applies to viral marketing campaigns. The word "viral" in viral marketing refers to popularity and exponential spread of ideas. When a marketing campaign becomes popular online at a very rapid pace, then it is considered viral marketing (Sexton 2011).

There are two broad ways to classify how corporate messages go viral: consumer-initiated viral marketing and business-initiated viral marketing. First, some companies receive viral promotion without investing any time at all. Through recommendation networks such as the iTunes Store and Amazon.com, well-received products begin to stand out, perhaps even ranking higher in popularity (Leskovec 2007). Second, some corporate messages become popular because consumers mention them through social media networks such as Facebook, Twitter, Tumblr, Pinterest, or YouTube (Chen 2010). We will refer to this kind of hands-off viral marketing as consumer-initiated viral marketing.

Companies do not have to be completely passive, and can indeed attempt to make their own messages go "viral." Hotmail.com successfully marketed their email service through viral means, by putting a signature at the bottom of user's emails linking to Hotmail, offering a free email address (Leskovec 2007). Old Spice made humorous videos on YouTube, which soon became very popular (Sexton 2011). In both cases, companies created the messages, which users disseminated and popularized. We will refer to this kind of hands-on viral marketing as business-initiated viral marketing.

The purpose of this paper is to provide managers, entrepreneurs, and marketers with the knowledge necessary to seed a successful business-initiated viral marketing campaign. First,

there will be a discussion of the underlying mechanics of viral marketing campaigns. This will allow for an informed overview of the advantages and disadvantages of viral marketing. Knowledge of these advantages and disadvantages will be used to suggest a model for marketers to use, which will maximize the chance of success in viral marketing.

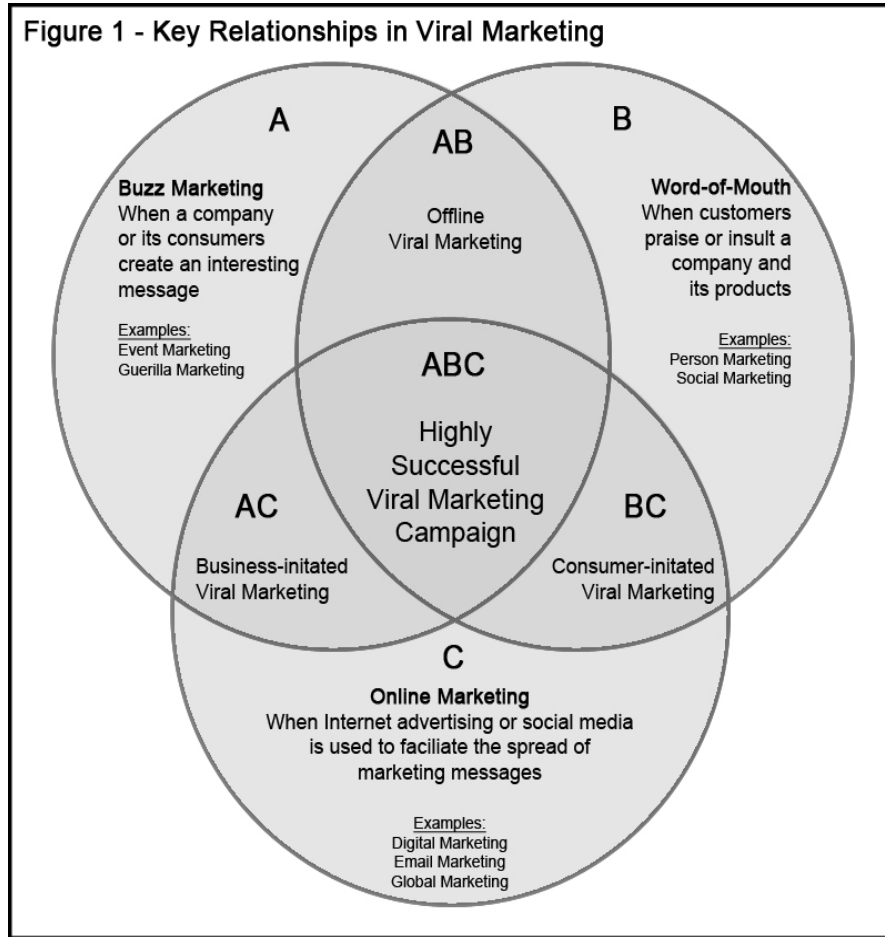
## LITERATURE REVIEW

Viral marketing, in the most literal sense, encompasses all marketing messages which are spread by consumer-to-consumer communication (AMA 2012). As such, it is one of the most basic marketing phenomena and it has existed long before present-day media. Viral marketing has become more powerful with the rise of the Internet and resulting online media. Today, the term “viral marketing” is used consistently in common vernacular to describe online business-initiated viral marketing campaigns (Summers 2012). Viral marketing, in the sense of its popular connotation, can be described as the relationship between buzz marketing, word-of-mouth marketing, and online marketing as shown in Figure 1.

Buzz marketing, word-of-mouth marketing, and online marketing are enumerated as the three primary antecedents of successful viral marketing campaigns (Figure 1). Section A represents buzz marketing, the practice of creating excitement through noteworthy marketing messages (Emakina 2007). Some examples would be based on event marketing, which uses significant events as opportunities to advertise through methods such as sponsorships (AMA 2012). Another example would be guerilla marketing, which hinges on unusual and eye-catching marketing methods such as sidewalk chalk arts that appear to be three-dimensional. Guerilla marketing is often used in an attempt to reduce costs (AMA 2012).

Section B represents word-of-mouth marketing. Word-of-mouth marketing occurs when consumers spread marketing messages to other consumers (AMA 2012). Before the Internet, word-of-mouth marketing was done in person, on the phone, or through mail. Word-of-mouth marketing is a broad spectrum of marketing phenomena that include consumers talking about notable marketing campaigns and product or service recommendations (Wiedemann 2010). Word-of-mouth can be facilitated by person marketing and social marketing. Both of these types of marketing attempt to influence consumer behavior. Person marketing influences individuals where as social marketing influences groups of individuals, or society at large (AMA 2012).

Section C represents online marketing, which covers all marketing messages facilitated by the Internet. One readily visible subset of online marketing would be banner advertisements on websites, a form of digital marketing. Email newsletters from companies would be an example of email marketing. E-commerce shopping experiences are also affiliated with online marketing, as well as global marketing (AMA 2012). This also includes consumer and business interactions on social media websites such as Facebook, Twitter, and YouTube.



Section AB is the overlap of Section A (buzz marketing) and Section B (word-of-mouth). Before the Internet, this was the primary definition of viral marketing (AMA 2012). When some marketing message generated buzz and people talked about it frequently, it became offline viral marketing. This still happens today, and is often a byproduct of successful online viral marketing (Sexton 2011).

Section AC is the overlap of Section A (buzz marketing) and Section C (online marketing). When companies successfully generate buzz on the internet, this is considered business-initiated viral marketing. Marketing messages that fall in this category are made by intentional efforts by businesses.

Section BC is the overlap of Section B (word-of-mouth) and Section C (online marketing). This is referred to as consumer-initiated viral marketing, and businesses have no direct impact on the spread of these marketing messages. This encompasses all of the communications that consumers have about businesses and their products and services that are facilitated by the Internet. This can also be referred to as “word-of-mouse” (Bampo 2008).

Section ABC is where buzz marketing, word-of-mouth, and online marketing meet. Companies that make strong marketing messages, or buzz, often succeed in indirectly creating word-of-mouth. Word-of-mouth, facilitated by the Internet, quickly becomes a rapid and exponential force of marketing, referred to as word-of-mouth marketing. In simpler terms, when companies create buzz on the Internet and consumers share it, a highly successful viral marketing campaign just occurs (Emakina 2007).

Audience participation is the foundation of viral marketing (Phelps 2004). Viral marketing messages cannot spread or “go viral” without meeting the viewer’s sharing threshold (Phelps 2004). Once this sharing threshold is met, the viewers of marketing messages will spread the message at a rapid pace, or in the most successful cases of viral marketing, at an exponential pace (Bampa 2008; Emakina 2007). In order for a marketing message to be spread at a viral pace, it must be especially relevant. Messages can achieve marketable relevancy through several means, including humor, visual impact or interesting content, interactivity, and enthusiastic peer-to-peer recommendations (Bampa 2008; Emakina 2007).

Many successful business-initiated viral marketing campaigns focus more on humor, content, and interactivity than advertising. These advertisements downplay the importance of the company, and clear the consumer’s impression that the companies have ulterior motives related to sales figures. The advertisements are made more for the consumer’s pleasure than the company’s success (Emakina 2007). Consumers see the company as a friendly organization, which makes the company appear more trustworthy (Emakina 2007). Trustworthiness makes consumers more likely to purchase products from the company (Emakina 2007).

The other form of viral marketing, consumer-initiated viral marketing, encompasses peer-to-peer recommendation networks, online and offline (Leskovec 2007). Because there is no direct corporate influence, recommendations from one consumer to another are perceived as pure and trustworthy. The nature of consumer-initiated viral marketing excludes businesses from directly setting consumer-initiated viral marketing trends. The only influence that businesses can exert upon this form of viral marketing starts from the beginning – production. Consumer-initiated viral marketing is honest and will reveal the flaws in low-quality products. Businesses are held accountable for their products, and must create better products to survive. The source of peer-to-peer reviews, or consumer-initiated viral marketing, makes it a trustworthy and powerful force in the business world (Leskovec 2007).

Consumer-initiated and business-initiated viral marketing both give power to the consumers. There is some social risk associated with giving power to consumers, but allowing consumers to discriminate the low-quality from the high-quality, whether advertisements or products, means only the consumer’s best wishes are fulfilled. A company known for high-quality products and messages will succeed, because consumers trust other consumers more than companies (Chen 2010). Marketing messages only “go viral” or spread by “word-of-mouth” when consumers trust and like a company. Because viral marketing gives consumers power over marketing messages, we can arrive at the following conclusion.

*P1: Consumers will perceive viral marketing as more trustworthy than traditional marketing-controlled information sources, since it is communicated via friends and trusted figures by “word-of-mouth.”*

The advent of the Internet and online commerce has removed many of the barriers to entry that small businesses often face, such as distribution channels, customer service, and corporate promotion. Financial assets tend to be quite limited for small firms, and consequently, marketing departments need inexpensive means of product and service promotion. The Internet provides a host of economically efficient alternatives to expensive marketing campaigns, such as mass media campaigns. Attempting to seed a viral marketing campaign is one such alternative (Bampo 2008). If it succeeds, consumers will do the majority of the talking regarding marketing messages, leading to smaller marketing expenses for the company (Emakina 2007).

New firms, small firms, and obscure firms frequently struggle from underdeveloped brand loyalty. Firms like this often operate by targeting niche markets. It is inefficient to attempt to generate buzz in niche markets by traditional mass media marketing. Below-the-line viral marketing techniques can be used to generate marketing buzz in a more focused manner by appealing to the unique aspects of the targeted consumers (Leskovec 2007).

After an initial buzz is started, either by consumer-initiated or business-initiated means, marketing messages spread by word-of-mouth (Emakina 2007). Eventually, successful viral marketing will cause the word-of-mouth to culminate into a well-established reputation. Reputations can be built from good reviews on recommendation networks (Leskovec 2007). For example, the reputation of Sennheiser, a high-end headphone and microphone manufacturer, has arisen predominantly from “audiophile” communities (Head Room). Blendtec, a firm that produces blenders, became famous by a business-initiated viral marketing campaign that involved blending strange items such as golf balls, marbles, consumer electronics, and a garden rake (YouTube 2007). The amusing nature of the videos and the clear demonstration of durability and utility have led the small startup firm to have a large and prominent online persona. Viral marketing helps remove obstacles that small and new firms face, therefore:

*P2a: Small and new firms are capable of using viral marketing to generate buzz and establish a reputation, similar to large and well-established firms.*

Reputation and buzz bring financial benefits such as market share and revenues. In the case of Blendtec, sales revenues increased by 500 percent between the first episode of *Will it Blend* in October 2006 and September 2007 (Nicole 2007). Blendtec claims to have created these original commercials with a budget of only \$50 (Blendtec Media Kit). Their blender products are all upwards of \$400 (Blendtec). Therefore, the revenue from selling a single blender covers the cost of the original commercials eight times.



Blendtec became extraordinarily popular within a remarkably brief time period. Blendtec annual sales after the video series on YouTube are “around 40 million dollars” (Blendtec Media Kit). Since the firm’s sales increased by 500 percent after the video series, it is safe to assume that sales revenues before the video series was closer to \$8 million (Blendtec Media Kit; Nicole 2007). Small firms can take advantage of this form of viral marketing to capitalize on buzz and reputation. Once excitement and trust are instilled in prospective consumers, revenues and market share often follow (Emakina 2007). This data suggests that

*P2b: Small and new firms are also capable of using viral marketing to secure significant portion of the market share and bring in revenues, since viral marketing buzz eases barriers to market entry.*

Viral marketing campaigns are not limited to small businesses with limited budgets. More established companies, such as Old Spice and Nike, can benefit from carefully planned viral marketing campaigns. Utilizing viral marketing can bring old brand or product line back to the forefront. In Old Spice’s 2010 campaign “The Man Your Man Could Smell Like,” the company did not promote anything particularly innovative. It merely gave people a reason to remember and discuss an old brand through sharing videos, and in many cases, quoting lines from them such as “look at your man, now back to me” (Sexton 2011). As of February 26, 2012, the original video of this marketing campaign has had nearly 40 million views (YouTube 2010).

Sometimes viral marketing can take a currently established and well-known brand, and bring it to a younger or different audience. Because viral marketing is perceived as organic, using viral marketing to promote an already established product line can make positive changes to brand perception. Chevrolet did something like this with their existing line of cars, Chevrolet Aveo. In 2012, Chevrolet released the car under the catchier brand name, Chevy Sonic (Healey 2010). They gave a free Chevy Sonic to a band named OK Go, for use in their music video for the song “Needing/Getting” (YouTube 2012a). This music video, like other OK Go music videos, is very elaborate and unusual (Bowie-Sell 2012). It shows the band riding in a Chevy Sonic, with poles attached to the side, which hit instruments as they drive. A short clip of this video was shown in one of the commercial breaks during Super Bowl XLVI (YouTube 2012a). The music video shows the car’s ability to handle well, even off-road. It also shows the logo of the car. However, it is still not an outright advertisement. This video has generated a buzz on the Internet, giving new life to a previously established brand. As of March 15, 2012, the “Needing/Getting” music video has been viewed nearly 17.5 million times (YouTube 2012a).

As target markets age, companies are often saddled with an unfortunate realization: an older target market cannot be sustained forever. Companies with aging target markets are forced to rebrand their products and services and essentially alter their company’s modus operandi to better suit a younger audience. Corporate attitudes have to change to reflect the younger audience. Launching a viral marketing campaign requires some background knowledge of

popular culture. Ergo, a successful viral marketing campaign demonstrates to the audience that the company is trendy and fresh. Levi Strauss, for example, rebranded their clothing line after finding out it did not appeal to a younger audience. After changing the product, they released a video on YouTube called “Guys backflip into jeans” which soon became viral (YouTube 2008a). This video had nearly 8 million views by March 15, 2012. Levi Strauss changed their jeans, made videos of young men jumping from objects like swing sets and seesaws into jeans, and effectively rebranded the company from the bottom-up using viral marketing in conjunction with product differentiation (YouTube 2008a).

Chevrolet, Old Spice, and Levi Strauss are all at least seventy-five years old. They are not considered to be young organizations. Yet, despite age, these companies have still benefited from viral marketing. This proves that viral marketing is not strictly the territory of the young and yet-to-be established corporations. Viral marketing can work for corporations of any size and age. Therefore,

P3: *Viral marketing campaigns can benefit older businesses by repositioning their overall marketing strategy, which can improve their reputation, generate buzz, improve market share, and increase sales.*

Many of the most successful business-initiated viral marketing campaigns are based on humor, interesting content, and interactivity (Emakina 2007, Phelps 2004). For example, a recent campaign by Old Spice called “The Man Your Man Could Smell Like” has become a textbook example of highly successful viral marketing. This campaign involved a series of entertaining dialogues delivered by former National Football League player Isaiah Mustafa (Sexton 2011). The first video in the series had nearly 40 million views on YouTube in its first two years and quotes from the commercials have found their way into popular culture (YouTube 2010). It succeeded because Mustafa’s monologues revolve around an amusingly smug character delivering ridiculous, surrealistic, and breathless claims of purported benefits that come from using Old Spice products (Sexton 2011). The description below the video on YouTube captures the spirit of the commercial series: “[we’re] not saying this body wash will make your man smell into a romantic millionaire jet fighter pilot, but we are insinuating it” (YouTube 2010). This series of commercials has benefited consumers by entertaining them.

Another successful viral marketing campaign was done by Burger King in 2004. This campaign is called “The Subservient Chicken.” It was a Flash-based game where users could enter one of hundreds of phrases in a text box, which would result in video clips of a man in a chicken suit acting them out (Snopes 2011). Some of the commands included “sleep,” “rage,” “fight,” “air guitar,” “the robot,” and several Michael Jackson dance moves. There are more than three hundred known commands for this campaign. The chicken responds to the names of some rock bands by doing the hand gesture for “I love you.” Even more amusing, the chicken responds to offensive suggestions by wagging his finger back and forth at the user (Wikipedia 2004). This

campaign is remarkable because of its amusing nature and its interactivity which surpassed the expectations of online consumers in 2004.

Nike also has adopted similar techniques by recruiting Kobe Bryant, a famous basketball player known for jumping ability for commercials. For these online videos, he performed stunts in Nike shoes that involved jumping over a speeding Aston Martin car and a pool of snakes (YouTube 2008b). These videos have shocked and confused consumers into wondering about the legitimacy of the videos. Whether they are real or not is debatable; but either way, consumers have enjoyed watching the crazy videos and discussing them (YouTube 2008b).

Nike seems to have met success with the “Kobe Bryant Jumps” videos, and they recently launched another video campaign named “the Kobe System.” This series has featured dozens of celebrities, all attending a self-help seminar hosted by Kobe Bryant, who gives them nonsensical advice such as “achieve success at success at success at success” (YouTube 2012). Seeing famous personalities such as Serena Williams and Richard Branson seeking Kobe Bryant’s advice at a self-help seminar is amusing, and consumers have shared these videos. Consumers seem to genuinely enjoy well-executed viral marketing campaigns, which suggests

*P4: Viral marketing campaigns can benefit consumers by promoting sharing, social connections, interactivity, and entertainment.*

Win-win conditions for businesses and consumers are frequently a result of viral marketing campaigns. Businesses generate buzz and build a reputation for themselves, while entertaining and facilitating social connections for consumers. There is a more concrete benefit of viral marketing campaigns that insofar has not been discussed. Viral marketing campaigns have the potential to be significantly less expensive than traditional mass media campaigns.

Using the Internet to disseminate a viral marketing campaign is not expensive. Many web hosting services provide acceptable web hosting service for less than \$100 per year (FindWebHosting.com). However, the price of a 30-second national television commercial is much higher, where production costs are typically closer to \$500,000 (Davis 2011). Websites also have the advantage of being global, customizable, and not limited by air time. Even when considering the cost of high-end graphic and web designers, creating a website for potential viral marketing is not nearly as expensive as traditional media. Websites such as Burger King’s Subservient Chicken were made for no other reason than to be viral marketing campaigns. Other companies can take advantage of this website-only approach to viral marketing.

YouTube provides a way for users to post videos online for free, with no limit to potential growth. There are still costs incurred in the production of a YouTube video, however, these are significantly lower than traditional campaigns as well. Many popular viral campaigns such as the aforementioned Blendtec and Old Spice campaigns, succeeded mainly through this website. In addition to YouTube, other social media sites such as Facebook, Twitter, Tumblr, and Pinterest show promising opportunities for viral marketing campaigns as well. Being able to

directly communicate with consumers at no explicit cost facilitates business-initiated viral campaigns with as little financial risk as possible. This is because

*P5: Viral marketing campaigns will have a significantly lower financial cost, compared to traditional marketing campaigns through mass media.*

There are commonalities among most of the business-initiated viral marketing campaigns mentioned in this paper so far. Levi Strauss, Old Spice, Blendtec, Nike, Chevrolet, Burger King, and Hotmail all started by creating what customers see as a valuable product. Levi Strauss rebranded their jeans to be trendier. Old Spice worked hard to create a satisfactory scent for their body washes and deodorants. Blendtec made a blender so powerful it could blend marbles. Nike strived to create comfortable, durable, and stylish shoes. Chevrolet made a car customers want to drive. Burger King emphasized customizability and customer-oriented food service. Hotmail created the first major email service for free, without any limiting conditions to inconvenience consumers.

Backed by a good product, all of these companies capitalized on creative thoughts, which in many cases, were limited to a small budget. All of these companies made something interesting, humorous, interactive, and/or shareable. Levi Strauss made videos of young men jumping into pairs of pants. Old Spice created bizarre and humorous commercials that switch rapidly from scene to scene. Blendtec destroyed garden tools and consumer electronics with their blender (Blendtec Media Kit). Nike worked with celebrities to create unbelievable videos, with the shoes being a minor point instead of a major attraction (YouTube 2008b). Chevrolet teamed up with the popular and stylized band Ok Go (YouTube 2012a). Burger King made a strange and amusing video game (Snopes 2011). Hotmail provided free email accounts.

If good products are advertised with humor, style, visual impact, free giveaways, or other interesting content, marketing messages will acquire viral potential. As long as the company seems genuine and friendly, interesting messages should be able to hold their viral potential (Emakina 2007). After viral potential is achieved, popularizing a marketing message should be as simple as using the right social networks as conduits. Whatever networks are popular on the Internet for a target market at the time should be used. As of today, Facebook, YouTube, and Twitter hold the most potential. Tomorrow, Tumblr and Pinterest may become better conduits. Marketers must keep an eye on emerging trends in social media in order to determine the right social networks for spreading potentially viral content. So far, it seems that

*P6: Successful viral marketing campaigns are more likely to succeed when marketers appeal to highly-connected individuals and opinion leaders with interesting, humorous, or interactive content.*

## MANAGERIAL IMPLICATIONS

Business-initiated viral marketing campaigns benefit from several advantages which make them worthwhile to consider in a practical managerial setting. The most easily quantifiable benefit of seeding a viral marketing campaign is the potentially low financial risk, such as Blendtec's \$50 budget for the first videos in the series *Will it Blend* (Blendtec Media Kit). Viral marketing messages thrive online, most likely as a result of the manageable expenses. Social media websites such as Facebook, Twitter, and YouTube, offer businesses viral marketing conduits completely free of charge. The only financial expense of using these social media channels is the implicit time value of the social media manager. Furthermore, the price of web hosting is often quite reasonable, at a price of less than \$100 per year for small business websites (FindWebHosting.com). The inexpensiveness of viral marketing allows small businesses to completely rely on it. Likewise, large businesses can choose to supplement their traditional marketing campaigns with inexpensive viral marketing campaigns (Emakina 2007).

An online presence is expected of businesses, regardless of size. Being online, in and of itself, does not provide businesses with a major advantage. Creating an interesting online experience that goes above and beyond consumers' expectations (Emakina 2007), however, can make significant improvements to a company's reputation. For example, when Old Spice introduced their viral marketing campaign "The Man Your Man Could Smell Like" and its associated website, body wash sales increased by 27 percent in six months and Old Spice became a trendier brand among younger males (Anderson 2012). This video series has had profound and almost unilaterally positive effects on consumers' perception of the company, as evidence by the 49:1 ratio of "likes" to "dislikes" on YouTube (YouTube 2010).

Viral marketing campaigns are unique, in that they often actively attempt to please and entertain consumers by appealing to basic consumer interests (Emakina 2007). Traditional mass media marketing, at best, can be humorous and quotable. Viral marketing, on the other hand, must almost always be humorous, entertaining, or interesting to succeed because consumers facilitate the message (Sexton 2011). Often, viral marketing will go above and beyond this by being interactive and social, as well. Fun marketing messages spread throughout the Internet like none other, benefiting businesses and consumers simultaneously.

Another significant factor in viral marketing is the sheer rate at which marketing messages are capable of spreading (Wilson 2005). A single status update by one Facebook user is theoretically capable of reaching thousands of people. Realistically, not all of a single person's Facebook friends will read and react to a single status update. Even still, if a person with 500 Facebook friends is capable of making 5 people react to a viral message, this message can disseminate at an exponential rate. Perhaps 5 of these 500 individuals will repost the status update, each causing 5 more people to repost (Wilson 2005; Emakina 2007). This example does not even include other social media sites such as Twitter, YouTube, Tumblr, and Pinterest.

Though there are many benefits to viral marketing, there is one major caveat to viral marketing of which managers need to be fully aware. Viral marketing relies on consumers, who add their own biases when spreading marketing messages (Emakina 2007). Word-of-mouth and word-of-mouse are affected both by the subjectivity of the message distributor and the message recipient. Marketing messages can take on a life of their own. There is a limit to which marketers can control viral marketing. This lack of control over marketing messages and their distribution should be a foremost concern in the mind of marketers who are considering seeding a viral marketing campaign.

Poorly conceived marketing messages can be misconstrued by consumers. In 2008, Cartoon Network attempted a viral marketing campaign for their show “Aqua Teen Hunger Force” in Boston. The end result of this was a bomb scare caused by poorly placed LCD light panels in the city. Cartoon Network, as expected, suffered from negative publicity and harsh criticism after this gaffe (CBS News 2009).

Even good marketing messages can attract the wrong consumers. Being supported by the wrong audience can turn a brand into a stigma. For example, if the Levi Strauss “Guys backflip into jeans” campaign had appealed to men older than 60 instead of the 18-25 demographic, Levi Strauss would have had a hard time maintaining their target audience. The company sales would increase in the short-run, but long-run concerns like an aging consumer base can cost a company dearly.

By attempting to seed a viral marketing campaign, companies are assuming a high degree of social risk. This is one unfortunate counterbalance to the low financial risk. Negative reviews and publicity spread even more rapidly on the Internet than good publicity. Consumers are empowered through viral marketing. Consumers can use their power altruistically by to informing other consumers about good products and services. Unfortunately for marketing managers, empowered consumers can also exact revenge on companies through negative publicity or even outright manipulation of information. Angry Internet users have exercised this ability against banks who tried to introduce monthly debit card usage fees. Even government bills are subject to empowered Internet users, (i.e. Stop Online Piracy Act and Protect IP Act). Consumers who feel offended or cheated by companies will strike back, sometimes with devastating social force.

Successful business-initiated viral marketing campaigns on the internet occur when buzz marketing generates word-of-mouse communication. Seeding a viral marketing campaign is, to some degree, predictable in nature. As stated in Proposition 6, “[s]uccessful viral marketing campaigns can be established consistently, if the marketers use current information distribution channels to appeal to highly-connected individuals with interesting or humorous content.” Adept managers with responsibility over viral marketing messages can use these commonalities to craft a successful campaign.

As with traditional mass media marketing or offline marketing, creating a buzz online relies heavily on the nature of marketing message to be spread. Marketers will need to carefully

analyze the target audience. Marketers need to know and understand the interests, motivations, likes, dislikes, and sharing habits of their audience. Viral marketing tends to target the trend-setting market demographic of 18-25 year-old men and women, since they actively use the Internet and social media for personal and practical reasons. Persons of this marketing demographic tend to respond to marketing messages centric around entertainment and interactivity. The way this demographic perceives the company will be especially positive if the company seems friendly, unique, and genuine.

Marketers then need to come up with an unusual and entertaining or interesting content to spread as a marketing message. The specifics of this content are reliant on the nature of the company's products or services and the company's corporate culture. Marketers in charge of making these messages need to be especially competent. The initial content in a business-initiated viral marketing campaign is where the greatest risk must be taken. The initial marketing message can propel a company to financial and social success or endanger the company's longevity.

After creating a great viral marketing message, finding the right online distribution channel should prove to considerably less difficult. Before choosing a social conduit for the marketing messages, marketers should consider three aspects: popularity, associated culture, and methods of sharing. Naturally, social conduits with a weak following do not make good locations for marketing message dissemination. Although, overpopulated social conduits may be difficult to use as well, due to all the social white noise of constant sharing.

The culture associated with the social conduits is also a point of consideration. Facebook and Twitter have different cultures, especially regarding message length. YouTube commenters are notorious among video sharing sites, regarding the often shocking candor of the commentary. Pinterest seems to appeal mostly to women. Initiating a campaign on any one site may require marketers to alter the message slightly.

Lastly, each site has different methods of sharing. Facebook revolves around brief status updates about the length of sentences, liking other pages, and sharing links. Twitter "tweets" are shorter than text messages in length. YouTube easily integrates itself into other popular social media. Tumblr tends to be more humorous and many of the users share videos and animated GIFs with each other. Until April 2012, Pinterest users were not capable of "pinning" videos. Every social conduit has its own social norms and folkways, which must be taken into consideration by marketers. Preferably, marketers should delegate social media power to employees who are enjoyably immersed in the culture of the websites on their own personal time.

## **RESEARCH IMPLICATIONS**

One commonly accepted assertion about viral marketing is that consumers see it as an inherently honest and trustworthy form of communication. Though little information has come

about to challenge this assertion, there is a lack of academic research proving that consumers consistently perceive viral marketing as honest. Even under the assumption that consumers did at some point perceive viral marketing as trustworthy, consumer sentiments toward viral marketing may have changed in a manner that the existent literature has not observed or predicted. Quantitative research in the form of well-designed opinion surveys could be used as a barometer to measure consumer perceptions toward viral marketing. This consumer perception research should be refreshed frequently, to account for the rapidly changing nature of the Internet, online social conduits, and viral marketing methods.

This paper establishes the theoretical possibility of small firms growing exponentially through viral marketing. Only Blendtec, however, was used pervasively as an example of small firm viral marketing success. There should be a closer examination of small firm viral marketing campaigns. Qualitative research could be used to provide detailed insights about the notion that small firms are consistently capable of marketing virally.

It seems that older and larger firms can use viral marketing to improve their reputation, generate buzz, and increase sales. Future research could compile a list of several large publicly-owned businesses that succeeded in seeding viral marketing campaigns. Each of these twenty-five businesses would be examined financially based on their annual reports to see if viral marketing increased sales revenues and profit margins. More sophisticated metrics could be developed to measure level of buzz and quality of reputation before and after the viral marketing campaign success.

Viral marketing campaigns are said to benefit consumers by being entertaining. This statement hinges upon an under-researched opinion of consumer perception. Opinion surveys could be used to compile and analyze consumer perceptions of viral marketing campaigns in terms of enjoyment and how willing they are to share the campaign. We need to investigate the possibility that consumers could be uninterested in or annoyed by viral marketing campaigns.

The notion that viral marketing campaigns cost less money than traditional mass media campaigns should be investigated in future research. Without the expenses incurred in buying television or radio airtime or physical advertising space, it seems that viral marketing campaigns would cost less than traditional mass media. A close analysis of the financial cost of seeding viral marketing campaigns would be immensely useful in the validation of the claim that viral marketing is relatively inexpensive. However, be aware that finding access to detailed financial documents may prove difficult for this sort of research.

Finally, there is the assumption that business-initiated viral marketing campaigns can succeed on a regular basis as long as two conditions are fulfilled. The marketing message must appeal to the target audience and the message distribution channel must be adequate for reaching the target audience. This assumption is the basis for much of the Managerial Implications section of the paper, where a marketing model is suggested for viral marketing. This idea needs heavy research in order to stand as a respectable theory.



Investigating this assumption will require very in-depth qualitative research, in the form of a case study. Small and new businesses interested in viral marketing would be researched in their efforts to establish viral marketing campaigns. The small businesses would follow the marketing model laid out in this paper as closely as possible. The businesses would develop content, which would be examined by a focus group comprised by their target audience. The focus group members would evaluate the content on two metrics. The first metric would measure whether the focus group members find the content entertaining or interesting. The second metric would measure whether the focus group members feel that the content is made with consideration of their interests, motivations, likes, dislikes, and sharing habits. Content would be revised until it passes evaluation for both of these metrics within the focus group.

After creating adequate content, small businesses would find the right distribution channel or social conduit to spread their marketing messages. To determine the right distribution channel, the target audience would be surveyed on their opinion of popular social media sites and viral marketing distribution methods. The results would be aggregated and the businesses would focus the majority of their viral marketing efforts on the social conduits that the survey respondents use and like the most.

The small businesses would all regularly follow up on their viral marketing successes. They would disclose relevant financial statements for analysis. Changes in sales revenue and profit margin would be used as measures of viral marketing financial success. Return on investment with respect to expenses incurred by viral marketing would also be used as an important metric of success. If attainable, data about changes in market share would make an excellent yardstick for viral marketing financial success.

These small businesses would also be evaluated on changes in marketing buzz and reputation. Google, Yahoo!, and Bing searches, website statistics such as page views, and level of social media activity could be used as measures of buzz. Target audience surveys could be used to measure reputation on a numeric scale after the viral marketing campaign. Again, search engine searches can also be used as measure of reputation, depending on the quantity of negative and positive searches.

Viral marketing on the Internet is still a fairly recent development in marketing. This paper has provided a framework for managers interested in viral marketing. However, this framework is untested and theoretical, so future research could provide beneficial insights on its relevancy.

## CONCLUSION

Business-initiated viral marketing campaigns have potential to spread marketing messages quickly and effectively. Viral marketing empowers consumers, meaning that businesses that satisfy consumers will reap benefits from consumer-to-consumer communication. Small firms and large firms are both capable of using viral marketing to their advantage. Smaller

firms can use it to establish a reputation and market share. Large businesses can use it to generate buzz, increase sales, or reposition their marketing strategy. Businesses and consumers both benefit from viral marketing: businesses can benefit financially and consumers can benefit socially. Viral marketing campaigns circumvent many of the costs associated with mass media campaigns, making them a logical choice for small firms trying to become popular and large firms looking to supplement their current marketing strategy. Finally, viral marketing campaigns can be implemented by astute managers who are familiar with the underlying mechanics of viral marketing. Creating consumer-pleasing content and disseminating it on topical online social conduits can consistently launch successful viral marketing campaigns.

## REFERENCES

- AMA (American Marketing Association), Dictionary, Retrieved March 25, 2011, from <http://www.marketingpower.com/layouts/Dictionary.aspx>.
- Anderson, Mae (2012). USA Today. Some old brands enjoy a revival, Retrieved April 18, 2011, from [http://www.usatoday.com/USCP/PNI/MONEY/2012-01-13-PNI0113biz-comeback-brandsPNIBrd\\_ST\\_U.htm](http://www.usatoday.com/USCP/PNI/MONEY/2012-01-13-PNI0113biz-comeback-brandsPNIBrd_ST_U.htm).
- Bampo, Mauro (2008). The Effects of the Social Structure of Digital Networks on Viral Marketing Performance. *Information Systems Research*, Vol. 19, No. 3, 273-290.
- Blendtec.. Retrieved March 13, 2012, from <http://www.blendtec.com/>.
- Blendtec Media Kit. Retrieved March 18, 2012, from <http://commercial.blendtec.com/media/pdf/commercial/BlendtecMediaKit.pdf>.
- Bowie-Sell, Daisy (2012). OK Go premiere elaborate new music video during Super Bowl. Retrieved March 15, 2012 from, <http://www.telegraph.co.uk/culture/music/music-news/9064293/OK-Go-premiere-elaborate-new-music-video-during-Super-Bowl.html>.
- CBS News (2009). 2 Arrested in Boston Bomb Scare. *CBS Interactive Inc.* Retrieved March 30, 2012, from [http://www.cbsnews.com/2100-201\\_162-2421734.html](http://www.cbsnews.com/2100-201_162-2421734.html).
- Chen, Wei (2010). Scalable Influence Maximization of Prevalent Viral Marketing in Large-Scale Social Networks. *KDD*, July 25-28, 1029-1038.
- Davis, Gary (2011). Frequently Asked Questions About Television Advertising. Retrieved April 7, 2012, from <http://televisionadvertising.com/faq.htm>.
- Dufour, Carole (2011). An Investigation into the Use of Viral Marketing for the Companies and the Key Success Factors of a Good Viral Campaign. *Dublin Business School*, 1-50.
- Emakina (2007). Viral Strategies and Buzz Marketing. Retrieved January 30, 2012, from <http://www.slideshare.net/emakina/viral-marketing-theory>
- FindWebHosting.com. Best 10 Web Hosting Companies. Retrieved April 7, 2012, from. <http://findwebhosting.com/>
- Head Room, Selection Guide: Full Size, Retrieved March 13, 2012 from <http://www.headphone.com/selection-guide/full-size-headphones.php>.
- Healey, James (2010). GM's Chevrolet Aveo renamed Sonic. USA Today. Retrieved March 15, 2012, from <http://content.usatoday.com/communities/driveon/post/2010/12/gms-chevy-aveo-renamed-sonic/1#.T2I2HBEgcTY>.
- Leskovec, Jure (2007). The Dynamics of Viral Marketing. *ACM Transactions on the Web*, Vol. 1, No. 1, Article 5, 1-39.

- Nicole, Kristen (2007). "Will it Blend" Videos Boost Sales 5x. Mashable, Inc. Retrieved March 13, 2012, from <http://mashable.com/2007/09/27/blendtec-sales/>.
- Palka, Wolfgang (2009). Mobile word-of-mouth – A grounded theory of mobile viral marketing. *Journal of Information Technology*, Vol. 24, 172-185
- Phelps, Joseph (2004). Viral Marketing or Electronic Word-of-Mouth Advertising: Examining Consumer Responses and Motivations to Pass Along Email. *Journal of Advertising Research*, Vol. 44, 4, 333-348.
- Sexton, Jarrett (2011). Viral Marketing. *SPORI Business Review*, Spring 2011.
- Snopes (2011). Burger King Subservient Chicken. Retrieved February 25, 2012, from <http://www.snopes.com/business/viral/chicken.asp>.
- Summers, Nick (2012) Click This Ad Already! *Newsweek*. March 18, 2012.
- Wiedemann, Dietmar (2010). Analyzing the Forwarding Behavior in Mobile Viral Marketing: An Empirical Study. *IGI Global*, 381-382.
- Wilson, Ralph (2005). The Six Simple Principles of Viral Marketing. *Web Marketing Today*. February 1, 2005.
- Wikipedia. The Subservient Chicken. Retrieved March 15, 2012, from [http://en.wikipedia.org/wiki/The\\_Subservient\\_Chicken..](http://en.wikipedia.org/wiki/The_Subservient_Chicken..)
- YouTube (2007). Will It Blend? – iPhone, Retrieved March 13, 2012, from <http://www.youtube.com/watch?v=qg1ckCkm8YI>.
- YouTube (2008a). Guys backflip into jeans, Retrieved March 15, 2012, from [http://www.youtube.com/watch?v=pShf2VuAu\\_Q](http://www.youtube.com/watch?v=pShf2VuAu_Q).
- YouTube (2008b). Kobe Bryant Jumps Over A Moving Car And A Pool Of Snakes, Retrieved April 7, 2012, from [http://www.youtube.com/watch?v=\\_Dcv9qzWrps](http://www.youtube.com/watch?v=_Dcv9qzWrps).
- YouTube (2010). Old Spice | The Man Your Man Could Smell Like, Retrieved February 26, 2012, from <http://www.youtube.com/watch?v=owGykVbfgUE,>
- YouTube (2012a). OK Go – Needing/Getting – Official Video, Retrieved March 15 2012, from <http://www.youtube.com/watch?v=MejbOFk7H6c>.
- YouTube (2012b). Nike: #Kobesystem – Level 7 Success at Success, Retrieved February 25, 2012, from [http://www.youtube.com/watch?v=CtIXGip\\_700](http://www.youtube.com/watch?v=CtIXGip_700).



## COVERED IN OIL – AGAIN

**Louis C. Mancuso, Southern University at New Orleans**  
**Biruk Alemayehu, Southern University at New Orleans**  
**Marjorie Anne Fox, Southern University at New Orleans**  
**H. Kevin Fulk, Southern University at New Orleans**

### ABSTRACT

*The South Louisiana coastline has experienced a number of natural and man-made disasters, beginning with the BP Oil Spill in 2010. These disasters have caused millions of dollars in damage in the form of human costs, environmental costs, and economic costs. This paper seeks to update the original South Louisiana study and compare the economic hardships originally felt in Louisiana with those that exist after Hurricane Isaac. In particular, this study investigates the continuing decline in the South Louisiana economy as a result of the spill.*

Key Words: *BP Oil Spill, Hurricane Isaac, Economic Effects of Natural and Man-Made Disasters.*

### INTRODUCTION

As residents of South Louisiana braced for the onslaught of Hurricane Isaac, they asked themselves the following question: Will we face only the traditional hardships associated with a hurricane, or will we be covered in oil again?

From April 20, 2010 to July 15, 2010, British Petroleum's Deepwater Horizon rig released 4.9 million barrels of Louisiana light sweet crude oil from the Macondo well into the Gulf of Mexico. It is thought that 1.1 million barrels of the oil are still polluting the gulf in the form of surface oil (light sheen), tar balls and submerged oil mats. (Tao et. al., 2011)

British Petroleum (hereinafter, BP), the company responsible for the Deepwater Horizon disaster, was asked to comment. On August 29, 2012, they assured the public that they did not expect any significant impact in the form of oil from the 2010 event being washed ashore by Hurricane Isaac. (Shauk, 2012) Their position was that they had cleaned up all of the oil and that the ecosystem was in recovery. (CBS/AP, 9/5/2012)

The Louisiana Governor's Office of Homeland Security and Emergency Preparedness was less sanguine. Their website advised residents that oil from the disaster might, in fact, be pushed ashore by the storm. (Shauk, 2012)

Residents remained uneasy. They recalled the rain of tar balls visited on South Alabama by Tropical Storm Lee and on South Mississippi by Tropical Storm Debbie. Confidence in the August 29, 2012 pronouncement of BP (soon to be indicted on 14 counts of criminal negligence,

including one count of lying to Congress about the volume of oil spilled) (Huffington Post, 2012) was low.

On August 28, 2012, Hurricane Isaac descended on South Louisiana, carrying large amounts of oil and tar balls that the storm scooped up from the floor of the gulf. BP challenged the assertion that the oil came from the Macondo well. Their challenge is not surprising, since if the oil was shown to be from the Deepwater Horizon spill, BP would have to help pay to clean it up. (Green, 2012) Fortunately, oil has a chemical fingerprint that makes it possible to identify its origin. (Gonzales, 2012) Testing proved that the oil was clearly from the Macondo well.

A new oil sheen appeared 50 miles off the Louisiana coast in early September. Tests confirmed that the oil was from Macondo. (WKRg.com NEWS5, 2012) Researchers from the University of Miami monitored the area of the original spill. They discovered upwelling of oil during Hurricane Isaac. (Gonzales, 2012) Once again, South Louisiana was covered in oil.

Economic effects were immediate. Commercial fishing and all shrimping were closed along 13 miles of the Louisiana coast because of the presence of tar mats and tar balls. (Goldenberg, 2012) Other coastal waters were already closed to fishing because of the continuing presence of Deepwater Horizon oil. (Gannon, 2012)

Environmental effects were also immediate. The Coast Guard found pelicans and other wildlife in the Louisiana marshes coated with the oil. (Smyth, 2012) The Louisiana Department of Wildlife and Fisheries confirmed the presence of oil-soaked birds. (Gannon, 2012) In nearby coastal Mississippi, tens of thousands of dead nutria corpses littered the beaches, creating rank odors and a health hazard. (Pappas, 2012)

Garret Graves, chairman of the Louisiana Coastal Protection and Restoration Authority, blamed the continued presence of a million barrels of oil in the gulf on BP's failure to clean it all up. He also commented that the amount of oil in question was four to five times the amount from the Exxon Valdez spill. (Smyth, 2012)

Instead of cleaning up the oil, BP used 2.1 million gallons of dispersants to sink it to the ocean floor. (Allan et. al & Goldenberg, 2012) The submerged oil formed mats, which are an ongoing threat to coastal ecosystems. (Msnbc.com, 2011) Furthermore, the oil does not appear to be breaking down or weathering, as many authorities thought it would. It appears that a lack of oxygen on the gulf floor has kept the oil mats relatively fresh and hardly changed. (Msnbc.com, 2011) In addition, "many scientists think that the interaction of the toxic dispersants with the crude oil creates an even more toxic overall effect." (Mancuso et al, 2012)

Since Hurricane Isaac, the realization appears to be growing that the negative effects of the Deepwater Horizon spill are a long-term problem. Oil from the spill reappeared on coastal beaches after Tropical Storms Lee and Debbie and after Hurricane Isaac. It is becoming clear that as long as a million gallons of oil remain on the gulf floor, there is an ongoing threat to the ecosystem.

Stuart Smith, a lawyer who represents hundreds of coastal property and business owners, is requesting that BP's proposed \$7.8 billion partial settlement to injured parties not be approved.

Smith argues that Hurricane Isaac shows that the spill has not been contained, that the oil is still affecting the area, and that the full extent of the damage cannot yet be determined. (GCaptain Staff, 2012)

Shortly after Hurricane Isaac, the Department of Justice urged “a federal judge to ignore arguments by BP that the Gulf Coast’s natural resources are making a robust recovery from the company’s massive oil spill.” (CBS/AP, 2012) The Justice Department is conducting a criminal investigation of the spill, alleging gross negligence and willful misconduct on the part of BP. (Kunzelman, 2012) A 2011 report by the Coast Guard and federal regulators found that “BP violated federal regulations, ignored crucial warnings and made bad decisions during the cementing of the well.” (Kunzelman, 2012) Furthermore, it appears that internal emails at BP could expose cover-up activities and intentional underreporting of the amount of oil flowing out of the damaged well. (Cousins, 2012)

Even before Hurricane Isaac, BP had begun to sell off assets in the Gulf of Mexico. The stated reason was to help pay for the expenses of the clean up. However, there is the concern that BP may be maneuvering to avoid aspects of its post-spill responsibilities. Alabama Congressman Jo Bonner stated, “Regardless of its business interests in the gulf, BP is still responsible for honoring its oil spill financial obligations under the Clean Water Act and the court-administered claims process.” (Williams, 2012) BP claims that the sale of almost half of its gulf assets is a strategic decision and says they will continue to invest in the gulf, adding two wells by the end of 2012. (Associated Press, 2012)

In mid-November 2012, BP was convicted of 14 felony counts related to the Deepwater Horizon oil spill. The conviction included a charge of obstruction of justice for lying to Congress about how much oil was gushing from the damaged well. The fine was set at \$4.5 billion, which is the largest corporate criminal penalty ever assessed. The fines will be assessed in addition to the settlements BP is required to make with property and business owners. The fine seems large until it is viewed in the context of BP’s profits for the quarter ending September 30, 2012. Quarterly profits were \$5.4 billion. (Huffington Post, 2012) In addition, “the Obama administration put a stop to new federal contracts with BP... admonishing the British oil company for a lack of business integrity and also disqualifying it indefinitely from winning new leases to drill on taxpayer-owned lands.” (Lederman, 2012)

Furthermore, the Environmental Protection Agency announced that the suspensions were being undertaken “due to BP’s lack of business integrity as demonstrated by the company’s conduct with regard to the Deepwater Horizon blowout, explosion, oil spill, and response.” (Lederman, 2012)

In 2011, the original economic effects of the oil spill in Louisiana were documented. (Mancuso et al, 2011). A later study discussed the economic effects in Alabama after Tropical Storm Lee. (Mancuso et. al, 2012) This paper seeks to update the original Louisiana study and compare the economic hardships originally felt in Louisiana with those that exist after Hurricane

Isaac. In particular, we wish to investigate a possible continuing decline in the South Louisiana economy as a result of the spill.

## METHODOLOGY

Data collection for this study was conducted twice in Venice, Galliano, and Grand Isle, Louisiana, in June 2010 (during the height of the oil spill) and in October 2012 (approximately one month after Hurricane Isaac hit South Louisiana). Southern University at New Orleans students majoring in Business Entrepreneurship, Public Administration, and Management Information Systems conducted both an intercept survey and a telephone survey under the supervision of the four authors. The questionnaire appears in Appendix A.

The June 2010 survey was strictly an intercept survey since business owners were willing to talk to the students at the Venice pier, Grand Isle grocery, and a big box store in Galliano. Unfortunately, this was not the case with the October 2012 survey. The Venice pier was closed due to damage from Hurricane Isaac and there was a dearth of business owners in both Grand Isle and Galliano. It should be noted that within three hours in June 2010, we obtained data from approximately 200 respondents; whereas, in October 2012 we obtained data from only thirty-three respondents via the intercept method. We collected the rest of the data in 2012 by calling business owners. It also proved to be difficult to obtain business owners' responses via the telephone. Approximately half of our potential survey respondents in Galliano and Grand Isle had disconnected telephones. We could neither travel to nor call Venice, Louisiana since Hurricane Isaac destroyed the highway, telephone lines, and cell towers. In addition, businesses were underwater in Venice.

### Research Issues

The objective of this research study was to investigate the economic effects of the BP Oil Spill that occurred during the height of the oil spill and after South Louisiana was inundated by Hurricane Isaac. The above objective is expressed in terms of a set of questions:

- Q1. Was your business affected by the BP Oil Spill?
- Q2. How much damage was done to your business by the BP Oil Spill?
- Q3. Did you file for compensation due to the BP Oil Spill?
- Q3A Are you going to file for compensation due to the BP Oil Spill?
- Q4. Did your company receive any compensation for its losses from the BP Oil Spill?



Q5. Compensation by Source

For questions 6, 7, and 12 respondents were asked to rate on a five point Likert Scale the extent to which they agreed with the statements comprising these questions.

Q6. Were you satisfied with your compensation for your losses from the BP Oil Spill?

Q7. I will be compensated fairly in the future from the BP Oil Spill.

Q8. Do you think you will be doing the same business in Louisiana in the next five years?

Q9. What is the approximate sales revenue per year with your business?

Q10. Assume your business income was 100% before the BP Oil Spill. What percentage of your business income has decreased today?

### **Data Collection and Analysis**

In June, 2010, one hundred percent of the surveys were gathered using face-to-face interviews; whereas, in October, 2012, only thirty-three of the ninety-three total surveys were gathered using this method. The other surveys were gathered by the telephone interviews. Following data collection, the survey data were tabulated. A number of descriptive statistics (e.g., percentage of respondents answering yes to a question) were generated. To facilitate understanding of the changing situation, as understood by survey respondents, comparisons were made between the first and second sets of results. The research results, in terms of the study questions, are presented below.

## **OUTCOMES**

### **Question 1: Was Your Business Affected by the BP Oil Spill?**

Table 1 displays a comparison of June 2010 responses to October 2012 responses. The results were similar for the two time periods. When asked if their business was affected by the BP Oil Spill, seventy-three percent of the respondents in 2010 answered yes. In 2012, sixty-nine percent of the respondents indicated that their businesses were affected.

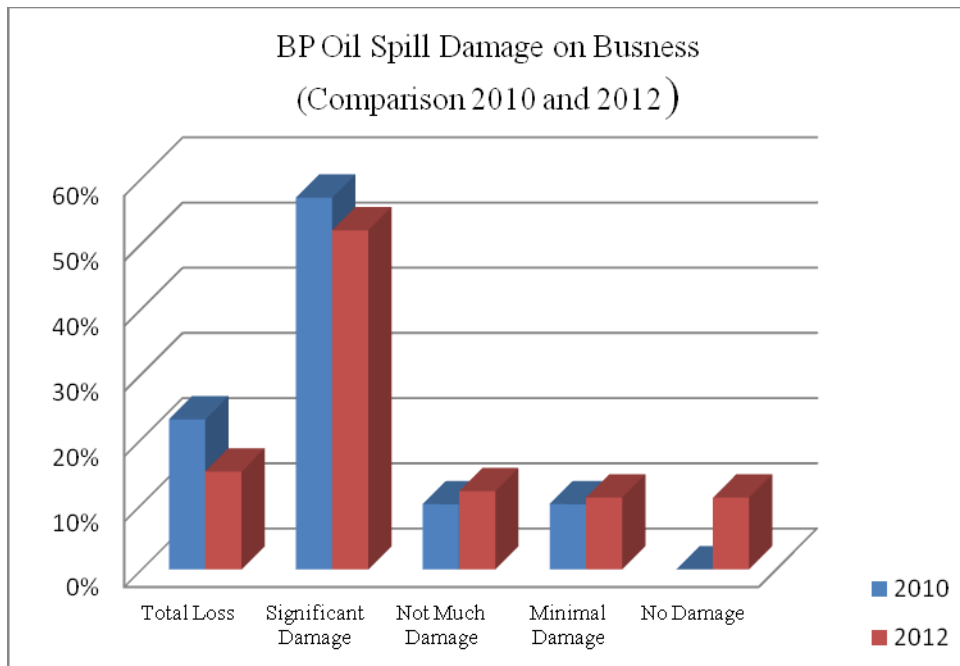
Responses	Number		Percentage of Total	
	2010	2012	2010	2012
Yes	153	64	73%	69%
No	56	29	27%	31%
<b>Total Responses</b>	<b>209</b>	<b>93</b>	<b>100%</b>	<b>100%</b>

**Question 2: How Much Damage was Done to your Business by the BP Oil Spill?**

More businesses experienced total loss or serious damage in 2010 than in 2012. The first two rows in the table add to 80 percent in 2010 vs. 67 percent in 2012. The table also shows that all businesses surveyed in 2010 experienced some damage, while 11 percent of businesses surveyed experienced no damage in 2012. The histogram in figure 1 reflects these results.

Responses	Number		Percentage of Total	
	2010	2012	2010	2012
Total Loss	35	10	23%	15%
Significant Damage	85	34	57%	52%
Not Much Damage	15	8	10%	12%
Minimal Damage	15	7	10%	11%
No Damage	0	7	0%	11%
<b>Total Responses</b>	<b>150</b>	<b>66</b>	<b>100%</b>	<b>100%</b>

**Figure 1: BP oil spill damages comparison for 2010 and 2012**



### Question 3: Did you file for Compensation due to the BP Oil Spill?

For question 3, the 2010 and 2012 results were quite similar. In 2010, 71% of the respondents indicated that they filed for compensation; whereas, in 2012, 70% of the respondents stated that they filed for compensation.

Responses	Number		Percentage of Total	
	2010	2012	2010	2012
Yes	108	47	71%	70%
No	44	20	29%	30%
<b>Total Responses</b>	<b>152</b>	<b>67</b>	<b>100%</b>	<b>100%</b>

### Question 3A: Are You Going to File for Compensation due to the BP Oil Spill?

Table 4 shows that 78% of the respondents surveyed indicated they would file a claim for compensation from the 2010 oil spill. The survey was conducted during the height of the spill and people were very hopeful that they would be compensated by BP. In 2012 only 39% of the respondents surveyed indicated that they would file for compensation. It is possible that respondents in 2012 had observed that BP was very tight-fisted with the distribution of compensation to the victims of the oil spill. The results suggest that study respondents had decided that compensation was not forthcoming and therefore saw no point in asking for compensation again.

Responses	Number		Percentage of Total	
	2010	2012	2010	2012
Yes	40	9	78%	39%
No	11	14	22%	61%
<b>Total Responses</b>	<b>51</b>	<b>23</b>	<b>100%</b>	<b>100%</b>

### Question 4: Did You Receive any Compensation for your Losses from the BP Oil Spill?

Forty-three percent of the respondents in 2010 stated they received compensation for their losses from the BP Oil Spill; whereas, 59% of the respondents in 2012 stated they received compensation.

Responses	Number		Percentage of Total	
	2010	2012	2010	2012
Yes	48	30	43%	59%
No	64	21	57%	41%
<b>Total Responses</b>	<b>112</b>	<b>51</b>	<b>100%</b>	<b>100%</b>

### Question 5: Did you receive any compensation (by source)

Table 6 displays changes in the sources of the compensation received by respondents. While 43% of respondents in 2010 indicated that they received compensation from an insurance company, 29% of respondents in 2012 said that they received compensation from this source. 25% of respondents in 2010 indicated that they received compensation from the Federal Government; this percentage fell to 11% in 2012. Finally, 32% of respondents in 2010 indicated that they received compensation from BP; this percentage increased to 60% in 2012.

Responses	Number		Percentage of Total	
	2010	2012	2010	2012
Insurance Company	30	10	43%	29%
Federal Government	17	4	25%	11%
BP	22	21	32%	60%
<b>Total Responses</b>	<b>69</b>	<b>35</b>	<b>100%</b>	<b>100%</b>

### Question 6: Were you satisfied with your compensation for your losses from the BP Oil Spill (by source)

Table 7 indicates that satisfaction of respondents with all three sources of compensation declined between 2010 and 2012. If we consider only those respondents who selected 'very satisfied' or 'somewhat satisfied,' we see that satisfaction with compensation from insurance companies dropped from 76% to 56%, satisfaction with federal compensation dropped from 60% to 37%, and satisfaction with compensation from BP dropped from 66% to 50%.

Responses	Insurance Company				Federal Government				BP			
	Number		Percentage of Total		Number		Percentage of Total		Number		Percentage of Total	
	2010	2012	2010	2012	2010	2012	2010	2012	2010	2012	2010	2012
Very Satisfied	19	4	51.5%	17%	6	1	30%	5%	33	6	42%	27%
Somewhat Satisfied	9	9	24.5%	39%	6	6	30%	32%	19	5	24%	23%
Neither Yes Nor No	3	2	8%	9%	3	7	15%	37%	7	1	9%	5%
Somewhat Dissatisfied	0	1	0	5%	2	0	10%	0	4	1	5%	5%
Very Dissatisfied	6	7	16%	30%	3	5	15%	26%	16	9	20%	40%
<b>Total Responses</b>	<b>37</b>	<b>23</b>	<b>100%</b>	<b>100%</b>	<b>20</b>	<b>19</b>	<b>100%</b>	<b>100%</b>	<b>79</b>	<b>22</b>	<b>100%</b>	<b>100%</b>

### Question 7: I will be compensated fairly in the future for the BP Oil Spill.

Question 7 addressed respondents' beliefs about their anticipated future compensation. Table 8 displays the results. When we consider respondents who selected 'strongly agree' or 'somewhat agree, we find that 37 percent expected to be fairly compensated by their insurance companies in 2010. None of the 2012 respondents applied for insurance compensation. It would be interesting to discover why there were no claims in 2012. Did mass policy cancellations occur after the 2010 disaster? Was insurance company response so poor in 2010 that respondents saw no point in applying in 2012?

Table 8 shows that expectations of fair future compensation from both the federal government and BP diminished between 2010 and 2012. In 2010, 59 percent of respondents strongly agreed or somewhat agreed that the federal government would compensate them fairly in the future. In 2012, the percent expecting fair compensation had declined to 23 percent. In 2010, 69 percent of respondents strongly agreed or somewhat agreed that BP would compensate them fairly in the future. In 2012, the percent expecting fair compensation had declined to 25 percent.

**Table 8: Expected future compensation**

Responses	Insurance Company				Federal Government				BP			
	Number		Percentage of Total		Number		Percentage of Total		Number		Percentage of Total	
	2010	2012	2010	2012	2010	2012	2010	2012	2010	2012	2010	2012
Strongly Agree	8	0	11%	0	16	6	25%	11.5%	21	2	33%	8%
Somewhat Agree	20	0	26%	0	22	6	34%	11.5%	23	4	36%	17%
Neither Agree Nor Disagree	17	0	22%	0	17	1	26%	2%	13	4	20%	17%
Somewhat Disagree	18	0	24%	0	6	14	9%	27%	4	14	6%	58%
Strongly Disagree	13	0	17%	0	4	25	6%	48%	3	0	5%	0
<b>Total Responses</b>	76	0	100%	0	65	52	100%	100%	64	24	100%	100%

### Question 8: Do you think you will doing the same business in Louisiana in the next five years?

Table 9 shows that the percent of respondents rating themselves as likely or most likely to be doing the same business in Louisiana in five years increased from 55% in 2010 to 77% in 2012. We attribute this increase to a 'survival of the fittest' effect. Our smaller sample size in 2012 reflects the large number of disconnected telephones we encountered in conducting our survey. It is logical to assume that many of these disconnected phones represented businesses that closed. It is likely that respondents who remained in business in 2012 were the stronger firms that had survived not only the original oil spill, but also the tropical storms and hurricane

that followed it. The probable elimination of the weaker firms from our sample is reflected in the increased proportion planning to stay in business.

Responses	Number		Percentage of Total	
	2010	2012	2010	2012
Most likely	51	53	28%	58%
Likely	49	17	27%	19%
Neutral	31	7	17%	8%
Unlikely	30	7	17%	8%
Most Unlikely	20	7	11%	8%
<b>Total responses</b>	<b>181</b>	<b>91</b>	<b>100%</b>	<b>100%</b>

**Question 9: What is the approximate sales revenue per year of your Business?**

Table 10 supports our hypothesis of survival of the fittest. The percent of businesses with revenues under \$100,000 declined from 51% in 2010 to 34% in 2012. At the same time, the percent of businesses with revenues of \$500,000 and above increased from 8 percent in 2010 to 19% in 2012. These results are consistent with the closure of many smaller, weaker firms and the growth of the strong survivors.

Responses	Number		Percentage of Total	
	2010	2012	2010	2012
Under \$100,000	93	29	51%	34%
\$100,000 to \$249,999	26	24	14%	28%
\$250,000 to \$499,999	48	16	27%	19%
\$500,000 and above	14	16	8%	19%
<b>Total responses</b>	<b>181</b>	<b>85</b>	<b>100%</b>	<b>100%</b>

**Question 10: Assume your business income was 100% before the BP Oil Spill. As of today, by what percentage has your business income decreased?**

Table 11 reveals that in both 2010 and 2012 the income of the average respondent decreased by 21 percent to 40 percent. However, it appears that in 2010, respondents experienced more severe losses (Thirty two percent lost 61 to 100 percent of their revenue as compared to 18 percent of respondents falling into this loss category in 2012). Correspondingly, more respondents in 2012 sustained smaller losses (Thirty nine percent lost 20 percent or less of their revenue as compared to 25 percent of respondents falling into this loss category in 2010).

<b>Responses</b>	<b>Number</b>		<b>Percentage of Total</b>	
	<b>2010</b>	<b>2012</b>	<b>2010</b>	<b>2012</b>
0%	31	20	17%	24%
1% to 20%	15	13	8%	15%
21% to 40%	32	21	18%	25%
41% to 60%	45	16	25%	19%
61% to 80%	39	6	22%	7%
81% to 100%	19	9	10%	11%
<b>Total responses</b>	<b>181</b>	<b>85</b>	<b>100%</b>	<b>100%</b>

## DISCUSSION AND CONCLUSIONS

Beginning in August 2010, South Louisiana suffered a number of natural and man-made disasters which caused millions of dollars in damage in human costs, environmental costs, and economic costs. With this paper, we update the original Louisiana study and compare the economic hardships originally felt in Louisiana with those that followed Hurricane Isaac. In particular, this study examined the continuing decline in the South Louisiana economy resulting from the spill.

As previously noted, the objective of this research study was to investigate the economic effects of the BP Oil Spill that occurred during the height of the oil spill and after South Louisiana was inundated by Hurricane Isaac. Our study's questions appropriately reflect this objective.

We now discuss this study's results. In both 2010 and 2012 a high percentage of respondents stated they were affected by the oil spill. Likewise, the respondents also indicated that in both years they had 'significant damage' to their businesses. Finally, similar high percentages of the 2010 and 2012 respondents indicated that they had filed for compensation.

An interesting change occurred in the percentages of respondents that indicated that they would file compensation claims. A far lower percentage of 2012 respondents indicated that they would file a claim than had been the case with the 2010 respondents. This change suggests that those affected by the oil spill had learned the lesson that they were unlikely to be successful in obtaining compensation.

Turning to the issue of compensation received, other interesting changes were noted among between 2010 and 2012. A greater percentage of 2012 respondents claimed that they had received compensation, compared with the percentage of 2010 respondents making this claim. A shift was also noted in respondents' satisfaction with compensation received from all three sources (insurance companies, the federal government and BP). Satisfaction declined substantially between 2010 and 2012.

The percent of respondents who expected to fairly compensated in the future for the BP oil spill declined substantially regarding compensation from both BP and the federal

government. No comparison is possible for expectation regarding compensation from insurance companies, since no claims were filed in 2012.

The percent of business owners planning to remain in the same business in South Louisiana increased between 2010 and 2012. This result is consistent with our hypothesis that the stronger and larger businesses survived. The shifts in business size by revenue displayed in table 10 also support this hypothesis.

In addition, we observed that between 2010 and 2012 there was a noticeable loss in population, reflected in business closures, telephone disconnects, and houses and businesses for sale. When the students and professors drove to Grand Isle and Galliano in October 2012, Grand Isle in particular had an inordinate amount of closed businesses, and houses for sale and/or rent. The dearth of business activity was shocking. For example, the professors and students went to lunch at the Subway on Grand Isle. The Subway only had three customers between Noon and 1:30 p.m (not counting our group).

Finally, in both 2010 and 2012 the income of the average respondent decreased by 21 percent to 40 percent. These averages mask the fact that there were a higher proportion of larger losses in 2010 and a higher proportion of smaller losses in 2012. These findings are consistent with the fact that in 2010 oil and dispersants spewed into the Gulf for an extended period of time, while in 2012 the effects of the hurricane and its aftermath were of shorter duration.

Future research can build upon the insights developed in this study. Additional studies should be conducted along the parameters of this study in the short-term every six to ten months to examine the ongoing effects of the oil spill over the longer term. The BP Oil Spill is an excellent example of how a major man-made disaster can have a variety of catastrophic effects on the 'economic way-of-life' of the community. In the future, researchers ought to continue to examine the nature of these effects and ways in which they change. Doing so will result in enhanced understanding of these disasters and, perhaps, help to better prepare citizens affected by similar events in the future.

## REFERENCES

- Allan, SE, Smith, BW & Anderson, KA (2012). "Impact of the deepwater horizon oil spill on bioavailable polycyclic aromatic hydrocarbons in Gulf of Mexico coastal waters." *Environmental Science & Technology, Volume 46, Issue 4, Feb. 21, 2012, ISSN: 1520-5851, p2033-9.*
- Associated Press (2012). "BP Sells Some Gulf of Mexico Assets for \$5.55B." *WKRG.com NEWS5, September 10, 2012.* Retrieved from [www2.wkrg.com/news/2012/sep/10/bp-sells-some-gulf-mexico-assets-555b-ar-4518500/](http://www2.wkrg.com/news/2012/sep/10/bp-sells-some-gulf-mexico-assets-555b-ar-4518500/)
- CBS/AP (2012). "Feds vow to prove BP's negligence in oil spill." *WKRG.com NEWS5, Published: September 05, 2012.* Retrieved from [www2.wkrg.com/news/2012/sep/05/feds-vow-prove-bps-negligence-oil-spill-ar-4484824/](http://www2.wkrg.com/news/2012/sep/05/feds-vow-prove-bps-negligence-oil-spill-ar-4484824/)
- Cousins, Farron (2012). "Internal BP Emails Could Expose Extent of Corporate Cover-Up of Gulf Oil Disaster." *Desmogblog.com, 10/05/2012.* Retrieved from [www.desmogblog.com/directory/vocabulary/5087](http://www.desmogblog.com/directory/vocabulary/5087)



- 
- Gannon, Megan (2012). "Tar Balls, Oily Pelicans Found in Isaac's Wake." *Live Science*, 05 September 2012. Retrieved from [www.livescience.com/22948-tar-balls-oily-pelicans-found-in-isaac-s-wake.html](http://www.livescience.com/22948-tar-balls-oily-pelicans-found-in-isaac-s-wake.html)
- GCaptain Staff (2012). "Isaac 'Tar Balls' Could Complicate BP's Oil Spill Settlement." *gCaptain maritime and offshore industry news blog*, September 11, 2012. Retrieved from [gcaptain.com/isaac-tar-balls-complicate/](http://gcaptain.com/isaac-tar-balls-complicate/)
- Goldenberg, Suzanne (2012). "Louisiana looks for 'smoking gun' to link Isaac tar balls to Gulf oil disaster." *The Guardian*, September 5, 2012. Retrieved from [www.rawstory.com/rs/2012/09/05/louisiana-looks-for-smoking-gun-to-link-isaac-tar-balls-to-gulf-oil-disaster/](http://www.rawstory.com/rs/2012/09/05/louisiana-looks-for-smoking-gun-to-link-isaac-tar-balls-to-gulf-oil-disaster/)
- Gonzalez, Barbara (2012). "Studies of Desoto canyon and shelf in Gulf of Mexico uncover upwelling during Hurricane Isaac." *University of Miami Rosenstiel School of Marine & Atmospheric Science, Public release date: 17-Sep-2012*. Retrieved from [www.eurekaalert.org/pub\\_releases/2012-09/uomr-sod091412.php](http://www.eurekaalert.org/pub_releases/2012-09/uomr-sod091412.php)
- Green (2012). "On Our Radar: Tar Balls on the Gulf Coast." *The New York Times, Green, A Blog About Energy and the Environment*, September 6, 2012. Retrieved from [green.blogs.nytimes.com/2012/09/06/on-our-radar-tar-balls-on-the-gulf-coast/](http://green.blogs.nytimes.com/2012/09/06/on-our-radar-tar-balls-on-the-gulf-coast/)
- Huffington Post (2012). "BP Oil Spill Settlement Announced, Robert Kaluza and Donald Vidrine Charged with Manslaughter." *Posted: 11/15/2012*. Retrieved from [http://www.huffingtonpost.com/2012/11/15/bp-oil-spill\\_n\\_2136063.html](http://www.huffingtonpost.com/2012/11/15/bp-oil-spill_n_2136063.html)
- Kunzelman, Michael (2012). "Gulf oil spill: BP to pay billions in U.S. criminal penalty" *Associated Press, November 15, 2012*. Retrieved from <http://www.naplesnews.com/news/2012/nov/15/gulf-oil-spill-bp-near-settlement-us-claims/?print=1>
- Lederman, Josh (2012). "BP barred from new US gov't contracts, land leases." *Huff Post Politics, November 28, 2012*. Retrieved from [http://www.huffingtonpost.com/huff-wires/20121128/us-gulf-oil-spill-bp-suspension/?utm\\_hp\\_ref=green&ir=green](http://www.huffingtonpost.com/huff-wires/20121128/us-gulf-oil-spill-bp-suspension/?utm_hp_ref=green&ir=green)
- Mancuso, Louis C., Alijani, Ghasem S., and Kwun, Obyung, (2011). "The Effects of the BP Oil Spill and Hurricane Katrina on Businesses in South Louisiana", *Entrepreneurial Executive, Volume 16, 2011, p71-81*.
- Mancuso, Louis, Marjorie Anne Fox and Biruk Alemayehu (2012). "BP Oil Spill Drains Alabama Economy – Again," *Franklin Business and Law Journal*, Vol. 2012, Issue 2, p. 1-20.
- Msnbc.com staff and news service reports (2011). "BP oil only slowly degrading on Gulf floor, study says." *Environment on NBC news.com, 9/20/2011*. Retrieved from [www.msnbc.msn.com/id/44600193/ns/us\\_news-environment/t/bp-oil-only-slowly-degrading-gulf-floor-study-says/#.UGEV07JISM0](http://www.msnbc.msn.com/id/44600193/ns/us_news-environment/t/bp-oil-only-slowly-degrading-gulf-floor-study-says/#.UGEV07JISM0)
- Pappas, Stephanie (2012). "Swamp Rats & Baby Dolphins! How Hurricanes Impact Animals." *Live Science, 04 September 2012*. Retrieved from [www.livescience.com/22913-nutria-dolphins-hurricanes-animals.html](http://www.livescience.com/22913-nutria-dolphins-hurricanes-animals.html)
- Shauk, Zain (2012). "Isaac could send tar balls ashore from 2010 spill, BP expects little impact." *Fuel Fix, posted on August 29, 2012*. Retrieved from [fuelfix.com/blog/2012/08/29/as-isaac-stirs-tar-balls-from-2010-spill-bp-expects-little-impact/](http://fuelfix.com/blog/2012/08/29/as-isaac-stirs-tar-balls-from-2010-spill-bp-expects-little-impact/)
- Smyth, Joe (2012). "Oil Washing Up On The Gulf Coast After Hurricane Isaac." *GREENPEACE The Witness, September 3, 2012*. Retrieved from [greenpeaceblogs.org/2012/09/03/photos-oil-washing-up-on-the-gulf-coast-after-hurricane-isaac/](http://greenpeaceblogs.org/2012/09/03/photos-oil-washing-up-on-the-gulf-coast-after-hurricane-isaac/)
- Tao, Zhen, Bullard, Stephen, and Arias, Covadonga (2011). "High Numbers of *Vibrio vulnificus* in Tar Balls Collected from Oiled Areas of the North-Central Gulf of Mexico Following the 2010 BP Deepwater Horizon Oil Spill." *EcoHealth. DOI: 10.1007/s10393-011-0720-z, 23 November 2011*. Retrieved from [www.ariaslab.org/Ariaslab/Home\\_files/Tao,%20Bullard%20%26%20Arias,%202011.pdf](http://www.ariaslab.org/Ariaslab/Home_files/Tao,%20Bullard%20%26%20Arias,%202011.pdf)
- Williams, Debbie (2012). "BP Selling Assets in Gulf." *WKRG.com NEWS5, August 15, 2012*. Retrieved from [www2.wkrg.com/news/2012/aug/15/bp-ar-4347135/](http://www2.wkrg.com/news/2012/aug/15/bp-ar-4347135/)
- WKRG.com NEWS5 (2012). "Is More Oil Leaking from Deepwater Horizon Well?" *Gulf Oil Spill News, 12/13/2012*. Retrieved from [www2.wkrg.com/list/news-gulf-oil-spill/](http://www2.wkrg.com/list/news-gulf-oil-spill/)
-

**APPENDIX A  
QUESTIONNAIRE**

**Southern Louisiana**

**Southern University at New Orleans**

**College of Business & Public Administration**

**Survey on the Effects of the BP Oil Spill on Small Business In Southern Louisiana**

# \_\_\_\_\_

1. Were you affected by the BP Oil Spill?

\_\_\_\_ Yes

\_\_\_\_ No (If No, please go to Question 8)

1) \_\_\_\_\_

2. How much damage was done to your business by the BP Oil Spill?

\_\_\_\_ Total Loss

\_\_\_\_ Significant Damage

\_\_\_\_ Not Much Damage

\_\_\_\_ Minimal Damage

\_\_\_\_ No Damage

2) \_\_\_\_\_

3. Did you file for compensation due to the BP Oil Spill?

\_\_\_\_ Yes (If Yes, please go to Questions 4)

\_\_\_\_ No (If No, please go to Question 3A)

3) \_\_\_\_\_

3A. Are you going to file for compensation due to the BP Oil Spill?

\_\_\_\_ Yes (If Yes, please go to Question 7)

\_\_\_\_ No (If No, please go to Questions 8)

4) \_\_\_\_\_

4. Did you receive any compensation for your losses from the BP Oil Spill:

\_\_\_\_ Yes

\_\_\_\_ No (If No, please go to Question 8)

5) \_\_\_\_\_

5. Did you receive any compensation for your losses from the BP Oil Spill from: (Check as many answers as appropriate)

\_\_\_\_ Insurance Company

\_\_\_\_ Federal Government (SBA, etc.)

\_\_\_\_ BP

6) \_\_\_\_\_

7) \_\_\_\_\_

8) \_\_\_\_\_

6. Were you satisfied with your compensation for your losses from the BP Oil Spill from:

Insurance Company:

- Very Satisfied 9) \_\_\_\_\_
- Somewhat Satisfied
- Neither Yes nor No
- Somewhat Dissatisfied
- Very Dissatisfied

Federal Government (SBA, etc):

- Very Satisfied 10) \_\_\_\_\_
- Somewhat Satisfied
- Neither Yes nor No
- Somewhat Dissatisfied
- Very Dissatisfied

BP:

- Very Satisfied 11) \_\_\_\_\_
- Somewhat Satisfied
- Neither Yes nor No
- Somewhat Dissatisfied
- Very Dissatisfied

7. Please rate the extent to which you agree or disagree with this statement: I will be compensated fairly in the future from the BP Oil Spill?

BP:

- Strongly Agree 12) \_\_\_\_\_
- Somewhat Agree
- Neither Agree nor Disagree
- Somewhat Disagree
- Strongly Disagree

Federal Government:

- Strongly Agree 13) \_\_\_\_\_
- Somewhat Agree
- Neither Agree nor Disagree
- Somewhat Disagree
- Strongly Disagree

Insurance Company:

- Strongly Agree 14) \_\_\_\_\_
- Somewhat Agree
- Neither Agree nor Disagree
- Somewhat Disagree
- Strongly Disagree

8. Do you think you will be doing the same business in Louisiana in the next five years: 15)\_\_\_\_  
\_\_\_\_ Most Likely  
\_\_\_\_ Likely  
\_\_\_\_ Neutral  
\_\_\_\_ Unlikely  
\_\_\_\_ Most Unlikely

9. What is the approximate sales revenue per year with your business: 16)\_\_\_\_  
\_\_\_\_ Under \$100,000  
\_\_\_\_ \$100,000 to \$249,999  
\_\_\_\_ \$250,000 to \$499,999  
\_\_\_\_ \$500,000 and above

10. Assume your business income was 100% before the BP Oil spill. As of today, by what percentage has your business income decreased? 17)\_\_\_\_  
\_\_\_\_ 0%  
\_\_\_\_ 1% to 20%  
\_\_\_\_ 21% to 40%  
\_\_\_\_ 41% to 60%  
\_\_\_\_ 61% to 80%  
\_\_\_\_ 81% to 100%

**Thank you for participating in the survey.**

# LOUD COMPUTING EFFECTS ON SMALL BUSINESS

**Ghasem S. Alijani, Southern University at New Orleans**  
**H. Kevin Fulk, Southern University at New Orleans**  
**Adnan Omar, Southern University at New Orleans**  
**Rohit Tulsi, Southern University at New Orleans**

## ABSTRACT

*Cloud Computing is a process of delivering services available in a host computer over the Internet. Cloud computing has distinctive characteristics that can differentiate it from the traditional hosting. It is available on demand and services are managed by the provider. Cloud computing offers a cost-effective alternative through improved utilization and reduced administration and infrastructure. Small businesses can benefit from cloud computing by implementing and managing their information systems using this tool. The objective of this research project was to study the benefits and drawbacks of cloud computing in terms of cost, data security, and data availability for small businesses. A survey and a data-driven model were developed to collect and analyze data concerning six major research issues. The surveys' distribution methods included face-to-face interviews, website responses, and emails. The results of the data analysis show that 59% of the small businesses using cloud computing were satisfied with the level of cloud security. Also 34% of the small businesses indicated that cloud computing can be considered a reliable information management facility. Further, 55% of the small businesses agreed that cloud computing is cost effective. The results of this study will assist small businesses to decide whether or not cloud computing is feasible for their daily operations.*

**Keywords:** Cloud Computing, IS Security, Small Business Infrastructure and Management

## INTRODUCTION

This research project is focused on cloud computing and its effects on small business in terms of cost, reliability, and security. Cloud computing is one of the new paradigms of information and communication technologies that provides opportunities to deliver computing services in new ways. Even though small businesses are aware of the benefits of cloud computing, there are many of them who are very reluctant to use cloud computing facilities as an alternative approach to manage their data and storage.

With cloud computing, the aim is to share resources, minimizing organizational expenditures and enhancing collaboration between networks or organizations. It enables the information technology service providers with new methods of doing business. In addition non-information technology companies can also benefit by facilitating cloud computing service.

More on the formal definition and features of cloud computing can be found in (Stanoevska, 2009; Grossman., 2009, and Sultan, 2010).

In cloud computing, organizational tasks are done by accessing the required applications through the Internet simply by using a web browser. In the cloud computing concept, organizations deal only with the software and do not need to think about the hardware at all unless they become Data Center Service providers. Among the popular cloud computing service examples are SalesForce.com, Google Apps, Amazon web services, and Facebook (Kambil, 2009).

There are some advantages and disadvantages associated with cloud computing. Lower hardware cost, improved performance of computers, lower information technology infrastructure cost, reduced maintenance issues, and lower software cost, represent a few of the main advantages. Additional advantages of using cloud computing include instant software updates, unlimited storage capacity, increased data safety, improved compatibility between operating systems, easier group collaboration, universal access to documents, and latest version availability. Among the few drawbacks are the requirement of constant high-speed Internet access (since most applications do not work well with low-speed connections), features might be limited, and stored data might not be secure (Miller, 2009).

The cloud is a metaphor for the Internet and is an abstraction for the complex infrastructure underlying it. It differs from traditional computing paradigms as it is scalable and it can be encapsulated as an abstract entity that facilitates different levels of services to clients. Further, it is driven by economies of scale and services that are dynamically configurable (Foster et al, 2008). Small businesses need to consider the benefits, drawbacks and the effects of cloud computing on their organizations and usage practices before deciding on its adoption and use (Fellowes, 2008).

Since large organizations are complex, it is very important for cloud computing to deliver real value rather than serve as a platform for simple tasks such as application testing or running demos. The need for cloud computing to deliver real value is a major issue for small businesses as well. For this reason, issues around migrating application systems to the cloud and satisfying the needs of small businesses should be explored. For small businesses, the cost factor is important but customer relationships, public image, flexibility, business continuity, and compliance are equally important (Khajeh-Hosseini, 2011). Small businesses need to understand the major concepts of cloud computing, including space, time, cost, availability, privacy and security.

The objective of this study was to investigate the benefits and drawbacks of cloud computing for small businesses. Three areas that were explored include cost benefits, data availability, and data security. Cost benefits of cloud computing include converting capital expenses to operating expenses (Armbrust et al., 2009). Usually cloud computing providers have detailed costing models which are used to bill users on a pay-as-you-go model (Khajeh-Hosseini,

2011). The data storage that small businesses are receiving from providers could be cost beneficial. However, it may not be as secure as it is expected.

Security of data is very much a concern of small businesses that adopt cloud computing. Most security issues are due to lack of control by the enterprise over the physical infrastructure. The security responsibilities of providers and consumers are dependent on cloud models (e.g., Amazon's AWS EC2) (Jensen, 2009).

## **BACKGROUND**

Cloud computing is a term used to describe both a platform and type of application. As a platform, it supplies, configures and reconfigures servers, while the servers can be physical or virtual machines. On the other hand, cloud computing may include applications that are extended to be accessible through the Internet and for this purpose large data centers and powerful servers are used to host the web applications and web services (Sharif, 2010).

Cloud computing has received significant attention from the media, as well as analysts because of the opportunities it offers. The cost of cloud computing has been estimated at three to five times less than the cost of traditional data and business/consumer application management (Lynch, 2008). According to a Gartner press release from 2008, Cloud Computing will be "no less influential than e-business" (Gartner, 2008). Enterprises such as Amazon and Microsoft have actively invested in their cloud computing infrastructures. Research indicates the revenue from cloud computing may exceed \$150 billion in 2013 (Burton, 2009).

For scalability, cloud computing offers efficiency and utilization of resources based on a 'pay-as-you-go' model that can greatly benefit small business by drastically decreasing their time to market as there are no initial cost barriers. Location independence is another key benefit of cloud services. Advances in wireless technology have made accessing the Internet on the move easier. Users can connect to their software applications and store data and information instantly over the Internet resulting in freedom from in-office infrastructure. For companies with multiple users in the field, applications no longer need to be installed directly onto the user's machine, making them run more efficiently and securely (Walsh, 2008).

There are also tiered, per-unit pricing, and subscription-based pricing models available to customers. Amazon cloud has adopted the tiered pricing model in which the cloud services are offered in several tiers and every tier provides fixed computing specifications (i.e. memory allocation, CPU type and speed, etc.) and SLAs (Service Level Agreements) at a certain price per unit time. Per unit pricing is mostly used with data transfer and memory usage. Finally, the subscription-based method is used for Software as a Service (SaaS). This method lets the users predict their periodic expenses of using cloud computing (Youseff, 2008).

The critics of cloud computing may argue that accessing key company applications over the Internet represents a security risk. Certainly, it is no less secure than the Internet, as the data that are stored on host servers are normally encrypted and would not be available to unauthorized

persons. Mostly the security issues which arise in cloud computing are the result of users (small businesses) lack of control of the physical infrastructure. Most small businesses are not aware of the location of their data and the security mechanisms used for that are applied to protection of data. For instance, they are not aware whether the data are encrypted or not and how data transmission encryption procedures and secret keys are managed (Security W, 2010).

Browser security is another issue since in cloud computing, most computations are done on remote servers and the client PC is only used for I/O and commands to access the cloud. A standard web browser is necessary to send I/O and commands. However, the use of web browser raises security question. The Transport Layer Security (TLS) plays an important role in this matter as it is used for host authentication and data encryption. The XML signature or XML encryption cannot be used by browser directly as data can be only encrypted using TLS and signatures are only used with the TLS handshake procedure. It can be stated that a browser only serves as a passive data store (Jensen, 2009).

Different researchers have pointed out many benefits of cloud computing, which make it preferable to be adopted by small businesses (Bailey, 2012; Panadian, 2012). Cloud computing infrastructure allows small businesses to achieve more efficient use of their IT hardware and software investments. This is achieved by breaking down the physical barrier inherent in isolated systems, and automating the management of the group of systems as a single entity. Cloud computing can also be described as an ultimately virtualized system and a natural evolution for data centers which offers automated systems management (Sharif, 2010).

## METHODOLOGY

Cloud computing refers to a process of delivering services (data, information, and applications) available in a host computer over the Internet. A cloud service has distinctive characteristics that can differentiate it from traditional hosting. It is available on-demand and the service is fully managed by the provider (the consumer needs nothing but a personal computer and Internet access). Significant innovations in virtualization and distributed computing and improved high-speed Internet access have accelerated interest in the cloud computing.

The objective of this project was to study the benefits and drawbacks in regards to cost, data security, and availability of cloud computing for management of small businesses' information systems. A data-driven model was developed and a survey form was designed that includes general and specific questions concerning use of cloud computing in a small business environment. The target participants included small businesses within the greater New Orleans and surrounding areas, clients of the university Small Business Management and Development Institute, and individuals who may consider using cloud computing facilities as an alternative for managing their data and storage. The surveys were distributed using face-to-face, websites ([www.facebook.com](http://www.facebook.com) and [www.freeonlinesurvey.com](http://www.freeonlinesurvey.com)), and email methods.

Surveys were distributed during September-November, 2012. The data collection



procedure was fairly simple and it gave the opportunity to participants to express their opinions during face-to-face interviews. Of the three hundred seventy (370) surveys that were distributed during the above time period, 216 (58%) of them were complete and considered as usable data. The following table shows the targets, as well as process of distributing surveys and collecting data.

<b>Method of Distribution</b>	<b>Distributed</b>	<b>Collected</b>	<b>Filtered (useable)</b>	<b>Percentile (%)</b>
Face-to-Face (individuals)	170	158	136	80
Email (using small businesses)	50	22	22	44
Website (using two web sites)	150	68	57	38
<b>Total</b>	<b>370</b>	<b>248</b>	<b>215</b>	<b>58</b>

As the table shows, the face-to-face distribution method had the highest return value of 80%. Out of 158 collected, 136 participants answered more than 90% of the questions (acceptable for data analysis). The second method with a high return rate (44%) was the email method where surveys were emailed to small businesses which cooperate with the university. Out of the 50 distributed, 22 were returned and they were completed. The method with lowest return rate (38%) was the use of websites. Out of 150 surveys distributed online, 68 were returned and 57 were filtered for data analysis. The overall combined methods, return rate is 58% which is relatively sufficient for data analysis.

The primary objective of the research project was to ascertain the participants' various views and concerns on using cloud computing for managing their information systems. To determine the views of participants, the objective must be quantified in terms of major research issues and evaluated based on analysis of collected data. As a first step, the objective was formulated in term of the following research issues:

- Issue-1: Size of small businesses and use of cloud computing
- Issue-2: Motivating factors for transferring to cloud computing
- Issue-3: Cloud computing providers
- Issue-4: Preferred billing methods
- Issue-5: Security and availability of cloud computing
- Issue-6: Main concerns of small businesses on the use of cloud computing

These issues will be discussed in the next section.

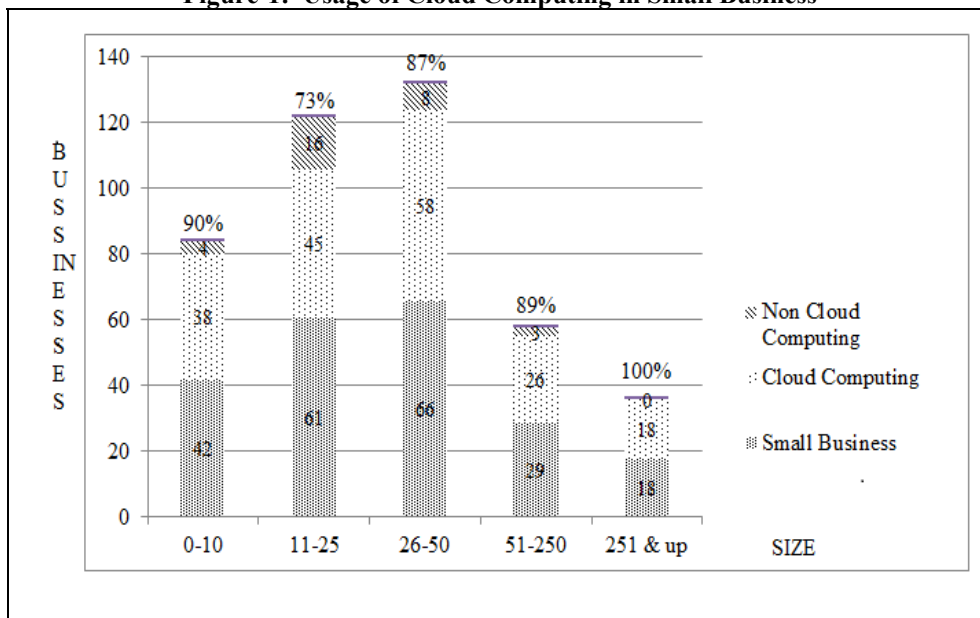
## FINDINGS

Two hundred sixteen (216) completed responses pertaining to the characteristics of cloud computing and users' perceptions were used as a basis for the study and following are the findings in terms of above main issues.

### Issue-1: Size of small businesses and use of cloud computing.

To investigate this issue, business participants were divided into different groups based on the number of their employees. Each of these groups may or may not use cloud computing facilities for managing their data storage. The following figure shows that out of 42 small businesses with 0-10 employees 38 (90%) of them use cloud computing facilities. A closer look at the Figure-1 reveals that the lowest percentage (73%) of cloud computing users are small business with 11-25 employees and the highest (100%) are businesses with more than 250 employees.

**Figure-1: Usage of Cloud Computing in Small Business**

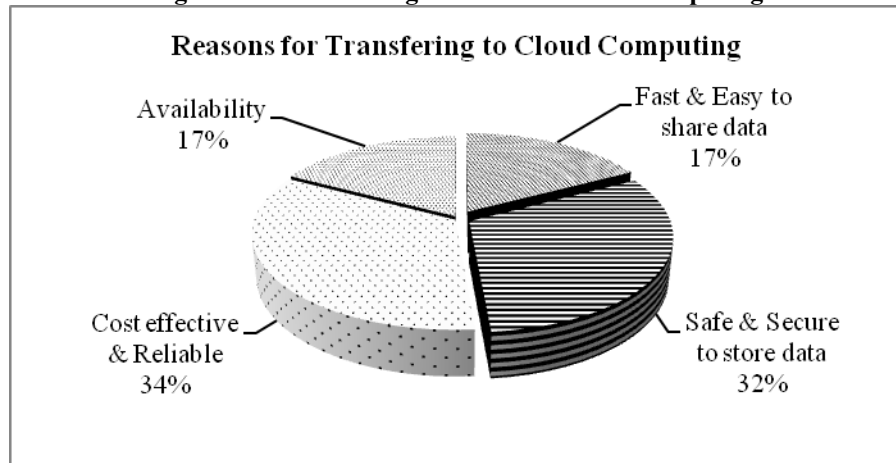


### Issue-2: Motivating factors for transferring to cloud computing.

The major reasons for transferring to cloud computing include availability, speed and easy to share data, cost effectiveness, and reliability. The following figure shows that 34% of the businesses moved to cloud computing as it is cost effective and reliable, and 32% of businesses

transferred because of safety and security. 17% of small businesses gave the availability of services and sharing data facilities as reasons for transferring to cloud computing.

**Figure-2: Transferring Business to Cloud Computing**

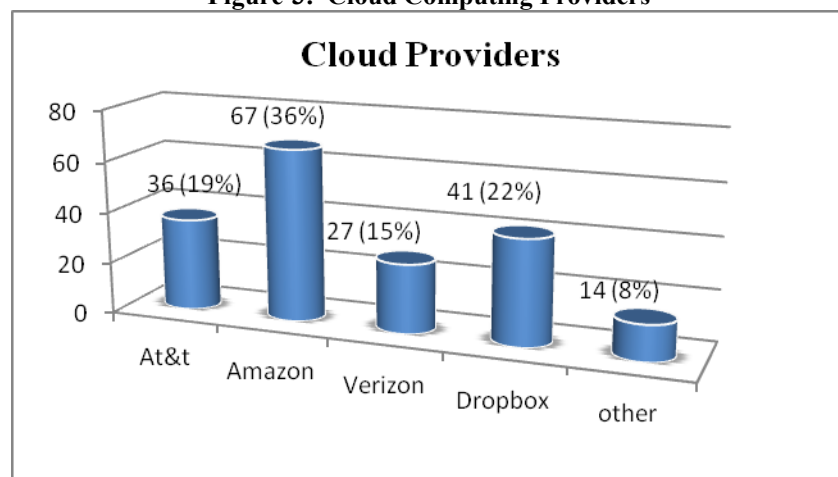


### Issue-3: Cloud computing providers for the businesses.

Out of 216 filtered sets of responses, 185 participants completed questions pertaining to this and the next three issues. Figure-3 shows the group of cloud providers. It shows that the highest percentage of the businesses that use cloud computing use Amazon as their cloud provider. Thirty six percent of the businesses are using Amazon as the service provider to store their data. The second largest provider for cloud users is Dropbox with 22%.

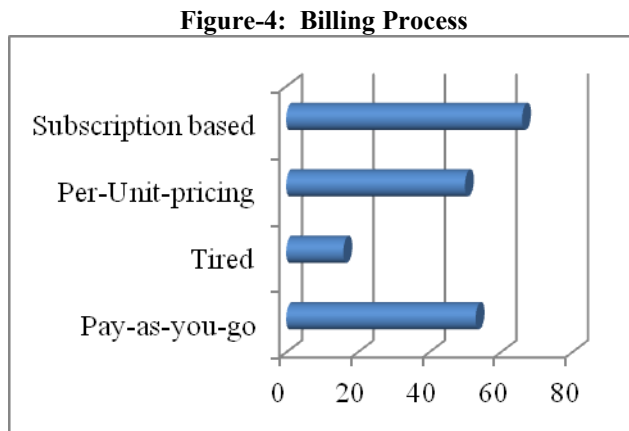
The lowest number (8%) of businesses used local (other) cloud providers including Oracle, IBM, and Bellweather cloud computing.

**Figure-3: Cloud Computing Providers**



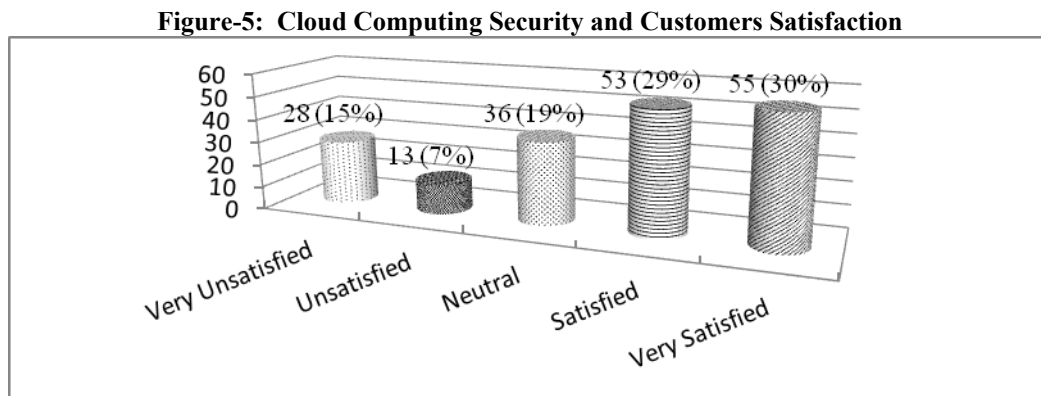
**Issue 4: Preferred billing methods.**

Figure-4 shows that the most commonly used billing process is the subscription method. The analysis is based on 185 completed answers concerning this issue. The next following the subscription method is the pay-as-you-go process. Most of the small businesses preferred the subscription method since it lets the users predict their periodic expenses of using cloud computing. The businesses that are using pay-as-you-go believe it is cost-effective.



**Issue-5: Security and availability of cloud computing.**

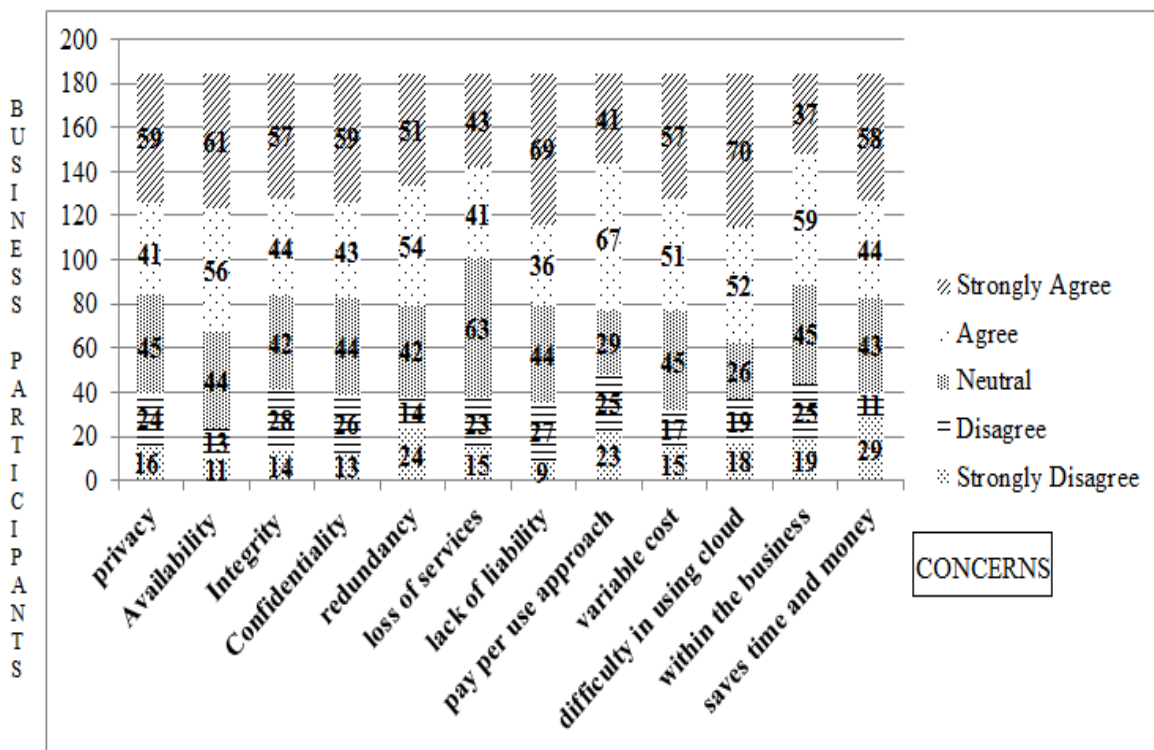
Even though the cloud computing is used in most of the target businesses, the survey shows only 30% of them are very satisfied with security provided by providers. Figure-5 depicts the customers who were satisfied by using cloud computing in their business. The overall 59% security satisfaction rate may be considered as an indicator of the confidence in cloud computing among the small business community.



**Issue-6: Main concerns of small businesses on the use of cloud computing.**

This issue reveals the concerns of small businesses about the implications of cloud computing. The data show that out of 185 participants, 70 (38%) of them strongly agree that it is difficult to use cloud computing services, while 69 (37%) of business strongly agree on the lack of liability. The data also reveals that 61 (33%) of participants strongly agree on the availability of services and confidentiality issues. A similar conclusion can be made on the issue of cost effectiveness.

**Figure-6: Concerns on Cloud Computing**



Overall, the analysis of data reveals that there are several reasons for small businesses using cloud computing that include cost effectiveness, security, availability of data, and reliability of system. The essence of cloud computing’s value may include speed, cost, easy to share data, security, and availability of services.

## CONCLUSIONS

Cloud computing is about sharing resources, minimizing organizational expenditures and enhancing collaboration between networks or organizations. It offers the information technology service providers a new way of dealing with data and storage management. Small businesses that intend to adopt cloud computing as an alternative to manage their information are facing a real dilemma as they hear positive and negative views from different sources. The objective of this research project was to study the benefits and drawbacks in regards to cost, data security and data availability that small businesses can benefit by using cloud computing to implement and manage their information systems.

To investigate the feasibility of cloud computing as data and storage management facilities, a data-driven model was developed and the research objective was formulated in terms of issues pertaining to the use of cloud computing in small businesses. The following are major results concerning each of the research issues.

<b>Issue</b>	<b>Results</b> (based on 185 out of 370 surveys)
Businesses using cloud computing	Lowest: 73% of small business with 11-25 employees Highest: 100% are businesses with more than 250 employees
Motivation factors for using cloud computing	Cost Effective: 34% Safety and Security: 32% Availability: 17%
Cloud computing providers	Highest: Amazon, 36% Lowest: Local, 8%
Security and availability	Satisfied: 59% Unsatisfied: 22% Neutral: 19%
Major concerns	Difficulties: 38% Liability: 37% Availability: 33%

### Limitations, Implications, and Recommendations

This study was conducted based on a limited range of small business participants. The participants expressed different opinions on transferring from the traditional business to cloud computing. The study provides useful implications for small business in transferring to cloud computing as an alternative for managing their data and storage. It is important to enhance this research by using a broader scope, a larger sample size, and a greater variety of businesses that confirm the use of cloud computing on a larger scale.

---

## REFERENCES

- Armbrust, M. F. (2009). Above the Clouds: A Berkley View of Cloud Computing. Technical Report . Berkley: University of California .
- Bailey, W. (September 24, 2012). What Small Businesses Need To Consider When They Go Cloud. Retrieved from <http://www.cloudtweaks.com/2012/09/what-small-businesses-need-to-consider-when-they-go-cloud/>.
- Burton. (2009). Cloud computing article. *Backup direct*. Retrieved from <http://www.backupdirect.net/cloud-computing>.
- Fellowes, W. (2008). Partly cloudy. *Blue-sky Thinking About Cloud Computing*. Retrieved from [http://www.the451group.com/reports/executive\\_summary.php?id=619](http://www.the451group.com/reports/executive_summary.php?id=619)
- Foster I, Z. Y. (2008). Cloud Computing and Grid Computing 360 - Degree Compared. *Grid Computing*. Retrieved from <http://arxiv.org/pdf/0901.0131>.
- Gartner. (2008). Gartner Says Cloud Computing Will Be As Influential As E-business. Retrieved from <http://www.gartner.com/it/page.jsp?id=707508>.
- Grossman. R. (2009). The Case for Cloud Computing. *IT Professional*, vol. 11, 23-27.
- Jensen, M. S. (2009). On Technical Security Issues in Cloud Computing. In *IEEE International Conference on Cloud computing (Cloud II)*.
- Kambil, A. (2009). A Head in the Cloud. *Journal of Business Strategy*, Vol. 30, No. 4, 58-59.
- Khajeh-Hosseini A, Sommerville I, Bogaerts J, Teregowda P. (2011). Decision Support Tools for Cloud Migration in the Enterprise, *IEEE 4<sup>th</sup> Int. Conference on Cloud Computing*, Washington DC.
- Lynch, M. (August 21, 2008). Merrill Lynch Estimates "Cloud Computing" To Be \$100 Billion Market. Retrieved from [virtualization.sys-con.com/node/604936](http://virtualization.sys-con.com/node/604936).
- Miller M. (2009). *Cloud Computing: Web based applications that change the way you work and collaborate online*, ISBN: 978076868622, Que Publications.
- Panadian, C. (September 13, 2012). Cloud Computing Tools for Business. Retrieved from <http://www.business2community.com/tech-gadgets/cloud-computing-tools-for-small-business-0279408#i5rxWBGmC8dbutFk.99>.
- Security, W. (2010). Retrieved from <http://www.windowsecurity.com/articles/Security-Cloud->.
- Sharif, A. (2010). the hype and promise of cloud computing. *Journal of Enterprise Information Management*, Vol. 23, No. 2., 131-134.
- Stanoevska-Slabeva, K., Wozniak, T., & Ristol, S. (2009). Grid and Cloud Computing: A Business Perspective on Technology and Applications: Springer, ISBN 978-3-642-05192-0.
- Sultan, N. (2010). Cloud Computing in Education. *International Journal of Information Management*, Vol.30, No 2., 109-116.
- Walsh, L. (2008). Pay-AS-You-Go Web Services. *Baseline*. Retrieved from <http://www.baselinemag.com/c/a/Web-Services-and-SOA/PayAsYouGo-Web-Services/>.
- Youseff, L. B. (2008). *Toward a Unified Ontology of Cloud*, Proceedings of IEEE 2008 Grid Computing Environment Workshop (GCE), Austin, Texas, November 2008.





# **A COMPARATIVE STUDY OF ENTREPRENEURIAL COMPETENCIES OF SMALL BUSINESS' OWNERS IN THE UPPER PENINSULA OF MICHIGAN, USA AND COMPANIES WINNING THE TOP PRIZE IN BRAZIL**

**Ana Alice Vilas Boas, The Federal University of Lavras, Brazil**  
**Tania Regina Frota Vasconcellos Dias, The Federal Rural University of Rio de  
Janeiro, Brazil**  
**Raymond Amtmann, Northern Michigan University**

## **ABSTRACT**

*This paper presents a discussion about competitiveness, competitive strategy and the entrepreneur's competences starting from (Man and Lau, 2000) researches. As a tool to subsidize this analysis, we adopted a descriptive and exploratory study. A questionnaire utilizing open questions was used. It refers to qualitative research performed through Content Analysis Method, having Categorical Analysis as the registration unit Theme. The main objective is to describe the existing relationship between competitiveness and entrepreneurial competences from the point of view of entrepreneurs who won the business TOP prize. It was observed that the Opportunity Competences, Relationship, Conceptual, Administrative, Strategic and Compromising are the most relevant points to achieving success as an entrepreneur, since they allow them to formulate strategies to achieve a high level of competitiveness. Supporting competences, or knowing how to learn, are important because they complete all the other competences and depend on the learning based on previous experience. These competences are inherent to the entrepreneur's success, for they are part of their background. A subsequent survey of entrepreneurs in the Upper Peninsula of Michigan, a rural area in the north central United States, was conducted to attempt to gain comparative data to see if any conclusions could be drawn between entrepreneurial drivers in these two diverse areas.*

**Key words:** Entrepreneur, competences, management

## **INTRODUCTION**

The globalization effects in the economy require a new productivity conception. "Nowadays, the companies, mainly the large ones, will not survive in this period of fast changes and innovation unless they acquire entrepreneurial competences" (Drucker, 2005: 200). Such a conception tends to assume the significance of global performance; thus, in the whole world, the

interest in entrepreneurship has grown up. The entrepreneurs show themselves as the main creators of working positions, which generate wealth. An understanding of behaviors related to entrepreneurial competences is critical.

For (Benício de Melo *et al.*, 2006) in the organizational studies field, including training and vocational development, it has been the global ambit with emphasis on the ability of improvement requirements and capabilities that generates reflections about professional practices.

According to (Baron and Shane, 2007), the entrepreneur has always been around, and they have always received attention in their societies; nevertheless, remarkable evidence points out that people are more and more seeking or taking on this role. For these authors many factors are involved. First of all, media is full of enthusiastic reports of successful entrepreneurs. Secondly, there was a fundamental change in what is called “employment bound contract,” that is, in the past, since the individuals performed their functions well, they would go on working; today, in a era in which the companies have restructured themselves, this type of agreement was discontinued. Thirdly, there was change in the basic values. Research reveals that youth, in particular, prefer a more independent life-style offering choices.

In Brazil, the studies started to take shape in the 1990’s when entities such as SEBRAE (*Serviço Brasileiro de Apoio às Micro e Pequenas Empresas*) and SOFTEX (*Sociedade Brasileira para Exportação de Software*) were launched (Dornelas, 2001).

“The word ‘entrepreneur’ has its origin in France and defines the one that takes risks and starts something new, different, to change the current situation and seek, in a constant way, new business opportunity, having as focus the innovation and the creation of value” (Dutra, 2003:35). Kirzner mentioned in (Dornelas, 2001: 31), “The entrepreneur is the one who creates a balance, finding a clear and positive position in an environment of chaos and turbulence, that is, identify opportunities in the current order.”

Schumpeter (1934) describes the entrepreneur as the one who causes the existing economic order to unbalance through the introduction of new products and services by creating new ways of organization or by exploring new resources and materials.

Nowadays there is no consensus about the definition of entrepreneurship as an area of business or as an activity in which people are involved. It is a process that moves itself in distinct phases but closely related to each other: recognition of an opportunity; deciding to go on and put together the initial resources; launching a new enterprise; building up the success and collecting the rewards (Baron and Shane, 2007).

In literature revisions about small-size and medium-size companies’ competitiveness, (Man *et al.*, 1999) recognizes three key-aspects that affect these companies’ competitiveness:

internal factors, external environment and the entrepreneurial influence. These factors bring impact to the company's performance in particular the entrepreneurial influence as for the competence in the behavioral perspective or process. The entrepreneur's demographic, psychological and behavioral characteristics as well as his or her managerial skills and technical know-how are often cited as the most influential factors related to the performance of a small and medium sized enterprise (SME) (Man, Lau and Chan, 1998).

Provided that entrepreneurial competences are considered important and consequently may be seen as the entrepreneur's total ability to conduct company development with success, this research aims to identify the entrepreneurial competences profile of those who own the Brazilian Business TOP Prize (TOP Empresarial, 2006) and to establish the relationship between these competencies and their competitiveness strategies. It will also compare these to entrepreneurs in the Upper Peninsula (U.P.) of Michigan (MI).

## COMPETENCE

According to (Dutra, 2004), some authors, most of them north-Americans as (McClelland, 1973; Boyatzis, 1982 and Spencer Jr. and Spencer, 1993), state that competence means the set of qualifications that one has to execute a work with a superior level of performance. During the 80s and 90s, many authors contested this definition of competence associated to the knowledge stored and people abilities, and they seek to associate the concept in their realizations and those things provided, produced and/or delivered by them. The fact of a person keeping the required qualifications for a work does not guarantee that he will deliver what is demanded from him/her. For (Le Boterf, 2003: 48), and other European authors state, "The competence requires an instrumentalization in knowing and capabilities, however it is not reduced to this instrumentalization." Yet according to the author, there is no competence unless it is put into action; the competence can only be competence in a specific situation. It is contingent. The know-how to act does not consist only in knowing to deal with an incident, but, equally, in knowing how to anticipate it. Nowadays, authors seek to think of competence as a summing up of these two thoughts.

Other authors approach the question of competence associated to the person acting in professional comfort areas, applying its strong points and having greater possibilities of realization and happiness (Schein, 1990; Derr, 1988). In this way, the person grows by mental capability, experience, knowledge and understanding and world comprehension and superior mental resistance and allows for adding value to the subordinate workers (Dutra, 2004).

Thus it is perceived there is a large diversity of concepts about competences. For this study, competence shall be defined as: a set of characteristics involving different personality traits, abilities and knowledge that are influenced by experience, capacity, education, family values and other demographic variables of the entrepreneur (Man and Lau, 2000).

## Successful Entrepreneur

In studies about entrepreneurs there is a consensus about a set of attitudes present in the subject entrepreneur. There are variables, of individual levels (techniques, motivations and characteristics of the entrepreneur); of interpersonal levels of grouping (ideas, information from other people, clients, potential employees, effectiveness in the interactions with risk capitalists) and, of social levels (governmental political, economical conditions, technology) that permeate all phases of the enterprising process (Baron and Shane, 2007).

To conduct a new enterprise in a satisfactory way, the entrepreneur needs to count on a broad variety of social abilities. These refer to a set of competences (isolated abilities) that allow the individuals to interact with each other.

Studies of Nahapiet and Ghoshal, mentioned in (Baron and Shane, 2007), identified five social abilities: Social perception – precision to understand others, including the correct understanding of their reasons, characteristics and intentions; Expressivities – ability to express their own emotions in such a way that they can be readily perceived by the others; Image administration – proficiency in the usage of techniques to induce positive reactions in the others when people meet for the first time; Persuasion and influence – ability to use several techniques to change attitude or behavior of others into the desired directions and, social adaptability – ability to adapt to a broad variety of social situations and to feel comfortable with individuals that are living so diversely.

“The entrepreneurs are differentiated people, who have a singular motivation, are passionate for what they do and don’t feel satisfied just by being another one in the multitude; they want to leave a legacy” (Dornelas, 2001: 19). Thus, the successful entrepreneur has extra characteristics, besides administrator attributes.

For (Dutra, 2003: 18), “The difference from the entrepreneur to the common administrator is that the entrepreneur goes beyond the normal tasks related to the administrators; they have a more broad view and are not happy just doing what has to be done.” They are provided with some personal attributes that, summed up, are sociologic and environmental characteristics that allow the blossoming of a new company. They are individuals that make a difference.

According to (Salim *et al.*, 2004: 5-6), the ten commandments of successful contractors that are important qualities and common to a great part of this group of entrepreneurs are:

**Take risks** – to consciously take risk, having courage to face challenges, of trying a new enterprise, of seeking, by himself the best ways, to have auto-determination

**Identify opportunities** – to be alert, and perceive, in the right moment, the opportunities that the market offers and unite the proper conditions for the realization of a good business, be aware of information

**Knowledge** – the greater the domain of a contractor in the business field, the greater is the chance for success. This knowledge may come from practical experience, information obtained in specialized publications, in educational centers or even from tips from people in similar enterprises.

**Organization** – to have the capability to use human resources, materials – financial and technological – in a rational way

**Take decision** – take correct decisions is a process that demands an information survey, a cold analysis of the situation, evaluation of the alternatives and the selection of the most adequate solution; the real entrepreneur is capable of taking the right decisions, at the right time

**Leadership** – To lead is knowing how to define objectives, orient tasks, combine methods, stimulate people in the right direction toward the desired goals and mediate balanced relations within the working team around the enterprise. Inside and outside the company, the businessman makes contact, be it with customers, suppliers, or employees. Thus, leadership has to be an ever-present quality.

**Dynamism** – a successful entrepreneur never settles down in order to not lose the capability of making simple ideas come true in effective business, to always keep dynamism and cultivate certain informality before the routine; independence – to determine his own steps, open his own ways, to be his own boss, in short, the search for independence is an important goal in the search for success. The entrepreneur must be free for new ideas and activities.

**Optimism** – this is a characteristic of people that see success, instead of just imagining bankruptcy. Capable of facing obstacles, the successful contractor knows to look beyond and above difficulties; business sense – (...) “sixth sense,” intuition, business sense is typical of people who succeeded in business most of the times and is the summation of all the qualities described here.

Dornelas (2007, 5-7) also describes several characteristics of successful entrepreneurs; they are individuals that make a difference; they know how to explore opportunities to the maximum; they are determined and dynamic; they are dedicated; They are optimistic and passionate for what they do; they are independent and build their own destiny; they become rich; they are leaders and team makers; they have good relationships (networking); they are organized; they plan; they have know-how; they take calculated risks; and they create value to the society.

Another set formed by ten characteristics of the successful entrepreneurs is used as reference by Sebrae for the Empretec, mentioned in (Dornelas, 2007: 8), intensive seminar, designed to increase the entrepreneur’s potential to better manage their enterprise, or to initiate a successful business, may be divided into three groups:

Group of characteristics related to realization: search for opportunities and initiatives, take calculated risks, demand for quality and efficiency, persistence and compromising;

Group of characteristics related to planning: search for information, goals establishment, planning and systematic monitoring;

Group of characteristics related to power: persuasion and contact network, independence and self-confidence.

Based on the set of these three sources it may be stated that the successful entrepreneur must be an individual with multiple competences and differentiated qualities. For this, it is relevant to know his competence areas and behavioral focuses.

### **Competence Areas and Behavioral Focuses**

In studies observed by (Man and Lau, 2000), they have categorized six competence areas, representing six distinct areas of entrepreneurs' behavior. The competences are divided into Opportunity, Relationship, Conceptual, Administrative, Strategic and Behavior, according to Table 1, which also shows the entrepreneurs' behavior focuses.

#### **Opportunities Competences**

Recognizing opportunities is a key phase in the entrepreneurial process. (Baron and Shane, 2007) explain that the core of opportunity recognition is in more access to information related with opportunities.

According to (Man and Lau, 2000), business recognition may be distinguished in three groups: identification, evaluation and search for the market opportunity. These groups suggest that the entrepreneur must be capable of identifying the favorable scenarios to the organizational objectives and act on the potential business opportunities by means of evaluation in order to transform them into positive situations. "It is necessary to be aware and perceive, in the right moment, the opportunities that the market offers and gather the appropriate conditions to perform a good business" (Salim, 2004: 5).

#### **Relationship Competences**

Social abilities are important. These include building up ability, keeping it, and using relationship networks, developing a long-term relationship based on the construction and confidence maintenance, good reputation towards potential customers, suppliers, shareholders and employees. It is also important to negotiate with shareholders, to manage conflicts, to build a consensus for decision-making and to efficiently communicate in order to promote products and services. (Man and Lau, 2000).

### **Conceptual Competences**

They are reflections of the entrepreneurs' action. Entrepreneurs are skillful observers, of external environmental opportunities as well as the organization's internal aspects. They bypass normal steps of the decision-making process and develop quick and intuitive actions. In parallel, they are capable to perceive situations from different angles or in positive ways, in order to find alternatives for the same question. They find niches for penetration in new markets. They innovate in the market by introducing methods, services, and technology applications, in ways of searching for products and distribution. They easily adapt themselves in a new situation. An efficient entrepreneur must have the capability to evaluate risks that come from his own actions in any one of the environments (Man and Lau, 2000).

### **Administrative Competences**

These are the abilities and knowledge for the development of the management functions for planning, organization, leadership, motivation, delegation and control. They must provide efficient allocation of human, physical, financial and technologic resources. When resources such as funds, partnerships and employees are not properly available in the company, the entrepreneurs need to gather them in the business environment in order to strengthen the potential of their company. He has to lead the employees and help them when there are difficulties and changes, motivating employees to achieve goals, using a reward system, counseling and encouragement (Man and Lau, 2000).

### **Strategic Competences**

The competences related to the choices and implementation of strategies in the company constitutes a special area of the entrepreneurial behavior. The efficient entrepreneurs not only have long-term sight, they plan objectives and medium-term positioning, reachable and realistic goals.

They develop opportunities in business, integrating the competitive scope with the administrative capabilities, adjusting to environmental changes. They direct the company strategies in response to the changes when adverse market and environmental conditions exist. They try to learn more about specific markets in order to establish their own position. They adopt tactics to face clients and competitors. They are responsible for estimating the financial viability of the control mechanism of their results (Man and Lau, 2000).

## Compromising Competences

These demand abilities of maintenance and dedication in business, above all in adverse situations. Such compromises may also be demonstrated by hard work and by desire to achieve long-term objectives in detriment to short-term earnings. One must have the capability to restart business activity, even after an unsuccessful situation, or must have the disposition to not give up a business in its growth period, even in case of a sector crisis. (Man and Lau, 2000).

<b>COMPETENCE AREAS</b>	<b>BEHAVIORAL FOCUS</b>
Opportunities Competences	Competences related to market opportunities acknowledgement in different ways.
Relationship Competences	Competence related to interactions based on relationships between individuals and individuals and groups.
Conceptual Competences	Competences inherent to different abilities that are reflected in the entrepreneurs' behavior.
Administrative Competences	Competences related to the organization of different internal and external human, physical, financial, and technological resources.
Strategic Competences	Competence related to the selection, evaluation and implementation of the company strategies.
Compromising Competences	Competences that demand ability to keep the business leaders' dedication.

Source: Adapted from (Man and Lau 2000:237)

Besides the competences previously mentioned the authors have identified another group of competences that provides support to the entrepreneur and are part of his background.

## Support Competence

According to (Man and Lau, 2000), other competences give support and depend on the entrepreneurs' personality. Since they are at the same time the owner, manager, and professional they must be good time managers. Time management is essential. Considering that entrepreneurs involve themselves a lot in their business, they also need to balance work, family, free time and health.

Other essential support is the ability to manage preoccupation and stress. In a recent study about entrepreneurs' competence, (Benicio de Melo *et al.*, 2006) mentioned a new competence connected to Equilibrium between Work and Personal Life. Their results point to two different directions: to deal with stress as an outflow and to have a comprehension of amusement / pleasure from work. According to the authors, the equilibrium between the work dynamics and the leaders' day-to-day life demands inspiration to search for escapes from physical and



psychological exhaustion as a chance to find creative escaping and fun formulas to guarantee a continuous state of personal and professional re-strengthening.

Based on this theoretical reference, it may be said that the entrepreneurs' competence group may determine the competition level of these entrepreneurs and their respective companies. Thus, a study that aims to relate competition and the entrepreneurs' competence may with significance contribute so that more companies become competitive by revealing the competence that their leaders must visualize and put into practice in day-to-day life.

## METHODOLOGY

This study has been characterized as an exploratory and descriptive research. According to (Mattar, 2001), descriptive and exploratory research is useful when there is a slight understanding of the problem and it aims to provide the researcher greater knowledge about the research theme. For (Gil, 2002), the descriptive research has as an objective to describe the characteristics of a certain population or phenomenon and the establishment of a relation between the variables involving the application of standardized techniques for collecting data such as questionnaires and systematic observation.

It is a qualitative research performed with five out of six entrepreneurs who had won the prize TOP business 2006, promoted by SEBRAE/RJ, in the Commerce, Education, Industry, Health, Services, Tourism and Energy fields.

As an instrument of data collection, a questionnaire proposed by (Man and Lau, 2000) was applied. This questionnaire was translated and systematically validated with two entrepreneurs before its application to the TOP business entrepreneurs. In the validation or pre-test there was only a suggestion; when one of the entrepreneurs put the two questions together in a single one, given one of them complemented the other without jeopardizing its content, the other questions were kept.

The questionnaire was made of open questions where the entrepreneur had freedom to write about the business development, critical moments, necessary competence so that success is achieved related to his company's performance. At the end, there was a question. What is being an entrepreneur? This questionnaire was sent by e-mail to the entrepreneurs belonging to the prizewinner companies after being previously contacted and agreeing to the research.

The data analysis took place through the Content Analysis Method, having the Theme as the unit register for Categorical Analysis. The investigation or Content Analysis Methods "...consists in discovering the <<sense cores>> that build up communication the presence, or showing frequency may mean something for the chosen analytic objective" (Bardin, 1977:105).

This analysis was chosen, because it allows the study of motivations, attitudes, values, beliefs and of tendencies opinion. The process takes place through the interviewed people reports transcriptions, contents codification and the interpretation of their meaning (Bardin, 1977).

A subsequent survey of entrepreneurs in the U.P. of MI, a rural area in the north central United States, was conducted to attempt to gain comparative data between these two realities. The questionnaire for U.P. was conducted with closed questions to gather information about entrepreneurs' profile and background. An open question was added to briefly explain their businesses. After that, a kind of Likert Scale was elaborated to gather their perception and views about their reasons for starting a new business, the factors for success and the barriers to success. This scale varied from Very Critical to Not Critical. In each of these sections there were presented sentences / statements for them to respond to. This questionnaire was available through the Internet from October 2009 to June 2010. It was sent via the Google Docs Platform to gather the data. At the end of this time the data was gathered into an Excel table to present a clearer idea of all responses.

## DEVELOPMENT AND RESEARCH RESULTS ANALYSIS

### The Business Top Prize

Having the State of Rio de Janeiro Government support, through the *Programa Qualidade Rio (PQR) (Rio Quality Program)*, and in partnership with the Gerdau Group, SEBRAE/RJ and FIRJAN, the *Prêmio Empresarial Top* (Business TOP Prize) aims to promote the acknowledgement initiative, actions and activities of the micro and small companies, settled in Rio de Janeiro State, for the application of technologies and management methods that have results in productivity and profitability gains, with consequent quality of life improvement for the communities where they dwell.

The evaluation encircle management aspects of the companies results, under the form of an adequate instrument to the micro and small companies characteristics and lined up with the following criteria utilized by the *Prêmio Nacional de Qualidade* (National Quality Prize) and by the *Prêmio Qualidade Rio* (Rio Quality Prize): Leadership, Strategy and Plans, Clients, Society, Information and knowledge, People, Processes and Results, in a total of 160 points.

The evaluation also occurs for the entrepreneurial side, in one of the following categories: Agro-business, Commerce, Education, Industry, Health, Services and Tourism. They may also be selected for special prizes, "Citizen" Company and/or conservation and usage of Energy and/or Rational Usage of Water.

The prize winning companies are Hidropartes Comercial Ltd launched in 1981, winner in the Commerce Sector and the special Citizen Company; Pedra Verde Laboratory, created in 1999, winner in the Health Sector; JJS General Sul Fluminense Services Ltd, launched 2000, winner in the Service Sector; Trilha do Sucesso Ltd Course, created 2003, winner in the Education Sector, and Magma Empreendimentos e Participações Ltd, launched 2005, winner in the Tourism Sector and the special prize for Conservation and Usage of Energy and/or Rational Usage of Water.

## **Research's Results Analysis**

The analysis categories were defined based on six competence areas by (Man and Lau 2000), as described in the theoretical reference, adding the support competence area. The codification of the contents and the interpretation of their meanings were performed after several readings and regrouping. It is important to identify these needed competencies as we compared the actions of the entrepreneurs from both Brazil and the Upper Peninsula of Michigan. We could then conclude what similarities existed and what differences were found.

### **Opportunities competence or to know how to act**

By the analysis, it was observed that initiative was important for these entrepreneurs to identify, evaluate and seek opportunities in the market. An entrepreneur said: “I chosen Macaé/RJ, where I am from, and to notice and believe at this region’s growth in the search for national self-sustainability, as well as, the almost inexistent hotel park.”

In a research performed by (Dornelas, 2007: 26), the author concludes, “The perception and the opportunities effectiveness are outstanding characteristics of the successful entrepreneur. Only 1% believes that ‘luck’ of being in the right place and moments was a booster for the enterprise”. Yet as a result of this research, “approximately 33% of the interviewees stated to be this opportunity the main influence factor to start their businesses, having that 77% from them said to have identified business opportunities” (Dornelas, 2007: 81).

To identify opportunities it is necessary to be aware of and to note, in the right moment, the opportunities offered by the market and acting on the business potential chances by means of evaluation in order to transform them into positive situations gathering the appropriate conditions for the realization of a good business. Besides that, having information is crucial.

According to (Salim *et al.*, 2004), the greater the domain of a contractor on the business field, the greater is the chance of succeeding. This knowledge may come from practical experience, from information collected in specialized publications, in learning centers or even from tips you take from people who have set up similar enterprises.

It is noted that these entrepreneurs have used information and experience (support competence) to recognize opportunities.

### **Relationship competence or to know how to communicate**

It has been observed that the importance of having social abilities, in a set of competences (isolated abilities), allows the individuals to interact with each other. For these entrepreneurs, “to build up and keep long term relationships with the parties directly involved their surroundings, contact networks and the communication” are part of the social abilities. The accuracy to

understand others, including the correct comprehension of their motives, characteristics and intentions are related to the social perception that the entrepreneur develops in his day-to-day life, as well as the social adaptability, given they adapt to a broad variety of social situations with their partners and agreements in their commercial relationships. For instance, one of the interviewers mentioned “to serve the other with love makes him sure that he did the best of himself, according to his consciousness, not just for a one moment or one trade, but also to propitiate the construction of solid relations, that contemplates the stakeholders.”

This knowledge comes from the congruent results referred by (Dornelas, 2007: 25). He concluded that the “contact network established is also a commonly present aspect in the entrepreneurs’ success. In more than 82% of the cases, the entrepreneurs consider themselves as having good relationships.”

In studies from SEBRAE-SP mentioned in (Dornelas, 2007: 81), “95% of the surviving entrepreneurs state they keep continuous contact with customers and partners.” The report GEM 2006 mentioned in (Dornelas, 2007: 81) shows “50% of the settled entrepreneurs personally know someone that has started a new business in the last two years. (...) Business generates more business and the good relationship generates a fecund environment for the entrepreneur.”

### **Conceptual competence or how to act, to learn, to compromise and to take responsibility**

The TOP Business entrepreneurs are “persistent”; “independent and self-confident”; “assume calculated risks,” for they have the capability to evaluate risk situations that come up coming from their actions in every environment. “In our kind of business, the gradual growth reaches a point where we can grow more, investing more, or paralyze the growth, keeping only small and ‘safe’ contracts. But, we decided to grow investing in the acquisition of new equipment, new contracts and specific services.”

It was also observed they are “creative,” given that they note situations through different angles or in a positive way in order to find alternatives to solve problems. They are “innovators” from birth, because they introduce new methods, services and use the technology, creating a value for their society.

By being successful entrepreneurs, they give importance to prizes and acknowledgement that make them feel proud of themselves and give self-esteem. Besides that, these entrepreneurs are “intuitive.” According to (Salim *et al.*, 2004), they have business instinct, (...) “sixth sense,” intuition, business feeling, typical of successful people in business, most of the time, the sum of all qualities described here.

Note that intuition blossoms in these entrepreneurs, but they seek to improve their planning process. As they won the TOP Business Prize, they have just gone into a self-evaluation instrument where several criteria were analyzed. Among these are Strategies and Plans – definition of the company strategies, as well as its development into plans and actions, definition

of indicators and goals. Therefore, planning will always be an important management tool, and it is contemplated in the administrative competences mentioned below.

This result reinforces what (Dornelas, 2007: 34) approached about myths and truths regarding entrepreneurs' "intuition will always be important, but added a criterions analyses of the company and its planning. Thus, the entrepreneur chances of success will increase."

### **Administrative competences or know how to mobilize**

It was noted in this research that planning is important to achieve success.. It is related to know how to search for partnerships and how to integrate them into business. For the interviewee "To achieve all planning goals," "Systematic planning," "establishment of goals" and "Search for information" are relevant to reach success.

Dornelas, (2007: 82) states in his research along with entrepreneurs that approximately 65% of the ones who achieved success have used some kind of planning, formal or informal." Similar results may be observed in (*Exame PME/Deloitte*, 2007) by indicating that 98% of the entrepreneurs that improved the most in the last few years have planned somehow. As well as, Sebrae-SP mentioned in (Dornelas, 2007:82) by spotting that "good planning before opening a business is one of the most important factors for the businesses' survival, (...) 83% of the entrepreneurs in activity constantly plan and 75% of them are ahead of the facts."

"Education and Capability" are important. Searching for the "management knowledge" growth, the "adequate educational formation to proposed challenges" is support competence, and for these entrepreneurs they are very important.

The entrepreneurs participating in the training offered by SEBRAE/EMPRETEC point out the desire for growth and to continuously improve their businesses, and this makes the market grow even more.

### **Strategic Competences or to have strategic vision**

The choice and the company strategies implementation constitute a special area of entrepreneurial behavior. For these successful entrepreneurs it is important to grow and to broaden their business by innovating it. Examining (*PME/Deloitte*, 2007: 36), research results show that, " from 100 small and medium size companies that have grown the most in Brazil, 88 consider themselves innovating ones because ... 57% have set up an innovative business model." Yet as results from this research, "46% have found a different way to offer an existing product or service and 37% have launched a new product or service in the market."

"Searching for the growth in the market through investment and new contracts." "It looks for growth in the market with investments and new contracts," "is to have a good feeling for business." For (Dornelas, 2007: 58), in his research "47.88% of the entrepreneurs have a good perception of how their business will be in future." For these entrepreneurs there is a strategic

challenge, “to increase the client base.” The compromise between quality and efficiency is resolved in “giving better solution, with quality, with experience, with price, with creativity, with law attendance, with socio-environmental responsibility.” As a result, they formulate in order to know and to understand deeply the organizations’ business and its environment, identifying competitive advantages and opportunities.

### **Compromising competence or to know how to compromise**

It was observed that there is a big compromise to keep business. An outstanding point is the discipline to make things happen. Having personal empowerment is the compromise with all people involved (stakeholders). This discipline may be the attribute that keeps the company surviving. One of the interviewees said, “I recognize that from the diversity I obtain strength to change it into an attractive business.”

According to (Dornelas, 2007: 82), researches developed by SEBRAE-SP “has evaluated that 95% of the surviving entrepreneurs consider themselves as persistent and 92% would ‘sacrifice themselves’ to achieve business objectives.”

As this competence is related to the ability to keep the leaders’ dedication to the business, it may be said that during the whole report of the collected answers, it was observed that in spite of all difficulties found by the entrepreneurs in keeping their objectives in various moments, they recognize that from adversity comes strength to transform it into good business.

In this moment, for some of them it is important to have spiritual support. *Faith in God! And Thanksgiving to God!* These are comments from the entrepreneurs, and it seems to be an aspect from the Brazilian culture.

### **Support competence or know how to learn**

Some competences are important and complementary for the competences previously presented. The know-how is related to overcoming after going through difficult moments, as one of them said: “knowing all the ‘ways’ of this segment.” According to the report GEM (2006), mentioned in (Dornelas, 2007: 80), previous professional experience is the main source of knowledge and learning for the established entrepreneurs. Most of these entrepreneurs have a variety of degrees such as Administration, Economy and Nautical Sciences. They have complemented their studies with extension courses in Economy and Law, with PhD and MBA. They have already worked in medium and large sized companies and the so-called multinational ones. They have occupied executive positions as managers, government representatives, operational supervisors, and buyers.

SEBRAE-SP, mentioned in (Dornelas, 2007: 80), found that “73% of the surviving entrepreneurs are still active have a High School background or more.” Yet in this research “69%

of the surviving entrepreneurs have previous experience as employees or were self-employed in the field of activity they go for” (Dornelas, 2007:80).

As for Ethics, this permeates all the entrepreneurs’ processes, being an important behavioral support. For them it means “having probity and the correct direction,” “an adequate moral formation to the proposed challenges,” “having a cautionary and correct conduction” and “being serious.”

It is important to point out that “Equilibrium, Work and Personal Life,” for one of them means “the search for the day-to-day improvement in the personal and professional life.” For (Mello *et al.*, 2006), this competence was built up by two categories: To release stress and having fun and a pleasurable understanding of their work. This result reinforces the equilibrium importance between the entrepreneurs’ professional and personal life.

## **RESULTS AND DISCUSSION ABOUT USA UPPER PENINSULA BUSINESS OWNERS**

The age range among USA entrepreneurs varies from 43 to 57 and all of them are male. Eighty three percent of them are currently married and seventeen percent are divorced. The highest level of education completed by 50% of these entrepreneurs is a Bachelor's Degree, but the other half only have a High School Degree. Their previous occupations were V.P. Manufacturing Operations, Architectural and Engineering Consultant (A/E Consultant), Manager, Restaurant owner and Toolmaker. Only one of them did not have any previous experience. Currently 50% of them are working with manufacturing, 16,7% work as A/E Consultants, 16,7% work in the hospitality sector and another 16,7% work with Manufacturing-Tool and Die/Plastics.

The A/E Consultant launched his business in 1957, and it is an employee owned company with multiple offices serving the Great Lakes Region. It mainly provides engineering and architectural service but also has planning and surveying. The contact person is the President. The other manufacturer started his manufacturing business in 1971. He works with sewing manufacturing with many different lines. Another one started in 1984. This company manufactures rough terrain forklifts used in the construction industry -- primarily supporting the housing-market. In 1998 a Manufacturing-Tool and Die/Plastics company was launched to deal with Plastic Product Development, for Medical, Packaging, Electronics, and Automotive Clients. It began strictly as a tool/mold maker; it now offers plastic molding, validation, process development, automation, and decorating as well. In 2003, a manufacturing company was opened to work with Precision Machining using Computerized Numerical Controlled (CNC) machines for the Diesel Engine, Mining, Construction and Automotive parts using raw materials such as cast iron, steel, aluminum, zinc, copper, brass etc. The newest business started in 2007. The owner is working in the hospitality sector and has a fine dining steak house featuring the finest quality steak, seafood, wine and spirits in the region. Thus, we may say that the oldest business has run for more than half century and the newest one started only 4 years ago.

The smallest business in number of employees is the restaurant with 35 workers. The next one, Manufacturing-Tool and Die/Plastics, has 55 employees, and the Consultant employs 68 people. In the sequence, next comes CNC with 86 employees, and the equipment manufacturer has 87 employees. The largest company in number of people working in it is the sewing manufacturing with 145 employees.

Since this study aims to analyze and identify key success factors and barriers to businesses in the Upper Peninsula, we present on Table 2 the business owners' views and perceptions about their reasons for starting their businesses. In this case they answered the question: How important were the following reasons to you when establishing your business? In order to do that they ranked the reasons using the following scale:

- 1- Very Critical (VC)
- 2- Critical (C)
- 3- Moderately Critical (MC)
- 4- Slightly Critical (SC)
- 5- Not Critical (NC)

Accordingly 5 out of the 6 owners stated the most critical reason for starting their business was because they liked the challenge. Just after that came personal need for growth, and opportunity to use their own knowledge and experience were mentioned as other critical or very critical reasons to start business. Apart from that, they stated that greater personal freedom is also critical in this perspective. These reasons reflect the **conceptual competence** that is inherent to different abilities present in the entrepreneurs' behavior. The less important reasons are loss of a job, unable to advance in their previous occupation and family tradition. It is worth mentioning that one of the respondents did not rank the reasons. So, the missing case is the same respondent in all topics.

In the sequence, the respondents were asked to manifest their reasons for success as shown on Table 3. The business owners were asked: How important do you find the following factors to be when running your business? (Or) How critical are they in the success of your business? They ranked these questions using the same pattern or scale as before.



Reasons for starting business	VC	C	MC	SC	NC	Missing cases
1. Greater personal freedom	1	3	-	1	-	1
2. Personal need for growth	2	1	2	-	-	1
3. Opportunity to use own knowledge and experience	2	3	-	-	-	1
4. Liked challenge	5	-	-	-	-	1
5. Disliked working for others	-	-	3	1	1	1
6. Unable to advance in previous occupation	-	1	1	1	2	1
7. Loss of a job	1	-	-	-	4	1
8. Influenced by family and/or friends	1	-	1	2	1	1
9. Family tradition	1	-	2	-	2	1
Source: Research data						

They stated the most critical factor for success in business is a good customer relationship followed by a good and responsive management team. The former was mentioned by 5 out of 6 respondents and the latter by 4 out of 6 respondents. Other very critical or critical factors are good product features and a good networking system. On the other hand, the slightly critical or not critical factors are spouse or family support, a good service and delivery system and availability of financial resources. It is possible to see that success is more related to good relationships with clients and employees, apart from the establishment of networking. All of them show that *relationship competencies* are also important for entrepreneurs.

Factors for Success	VC	C	MC	SC	NC
1. Availability of financial resources	2	2	1	1	-
2. A good service and delivery system	1	-	1	2	1
3. A good customer relationship	5	1	-	-	-
4. Good product features	3	3	-	-	-
5. A good networking system	3	2	1	-	-
6. Spouse/family support	2	-	4	-	-
7. Ability to develop and sustain a technological advantage	2	2	1	-	1
8. A good and responsive management team	4	2	-	-	-
Source: Research data					

Regarding barriers to success, the entrepreneurs were asked: How critical were the following problems to you when your business was emerging? In other words, how detrimental were they to your success? The respondents ranked them on the same scale as shown on Table 3

According to the Upper Peninsula business owners, the most critical barriers to success are shortage of capital and economic recession. In this context, critical barriers are related to marketing their own products or services, strong competition because of the many competitors, economic recession, followed by lack of skilled or trained workers. Some of the respondents also

mentioned inability to obtain sources of financing, inability to understand financial issues, inability to understand industry trends, lack of managerial skills and shortage of workers as critical barriers to achieving success in a new business. We may say that most of these barriers can be overcome when business owners develop **administrative, strategic and compromising competencies**.

<b>Table 4: Barriers to success in USA small business Upper Peninsula</b>					
<b>Barriers to Success</b>	VC	C	MC	SC	NC
1. High cost of labor	-	-	3	1	2
2. Shortage of capital	2	-	2	-	2
3. Inability to obtain sources of financing	-	1	2	-	3
4. Inability to understand financial issues	-	1	1	-	4
5. Strong competition	-	2	3	1	-
6. Too many competitors	-	2	2	2	-
7. High cost of supplies and materials	-	-	3	2	1
8. Economic recession	1	2	1	1	1
9. Producing the product(s)	-	-	2	2	2
10. Inability to understand industry trends	-	1	1	1	3
11. Marketing your products/services	-	3	-	1	1
12. Lack of management skills	-	1	2	1	2
13. Shortage of workers	-	1	1	1	5
14. Lack of skilled/trained workers	-	2	-	2	2
Source: Research data					

On the other hand, Table 4 shows that some entrepreneurs considered too many competitors, high cost of supplies and materials, producing their own products and lack of skilled or trained workers as slightly critical barriers. It is worth stating that 5 out of 6 entrepreneurs do not see a shortage of workers as an important barrier to achieving success in a new business. Apart from that, 4 out of 6 believe that inability to understand financial issues is also not critical in business. And 3 out of 6 believe inability to obtain sources of financing and inability to understand industry trends are not critical. This data showed external issues are less critical than internal or closed business issues are for successfully managing a new business in this area of the USA.

## CONCLUSION

As with the work of (Man and Lau, 2000), this study reinforces the existence of the six entrepreneurial competencies in Brazilian and American entrepreneurs: Opportunity Competence, Relationship, Conceptual, Administrative, Strategic, Compromising, as well as Support Competences. It is worth pointing out the importance of the Conceptual Competence of Support. These are inherent to the successful entrepreneurs and are part of their background.

For these entrepreneurs, being innovative, thinking intuitively, taking calculated risks, looking through a different lens (creativity), having independence and self-confidence, being persistent, being proud and having self-esteem and high performance are competences inherent to the entrepreneurs and important to achieving success. As support competencies, the formal education and capability, as well as ethics, bring learning, resulting from experiences lived in difficult moments and are also relevant to successfully building the successful entrepreneurs' profile, because this empowers them to succeed. These results confirm the findings of several other authors that were mentioned in the development of this work. It can also be added, that the stimulus provided by being awarded a prize, motivated the Brazilian entrepreneurs to continue in their enterprises, which was even more enhanced by faith in God.

It can also be seen that the successful entrepreneurs from the U.P. exhibited many similar competencies to their Brazilian counterparts. While entrepreneurial success cannot be determined by acting exactly the same way in different cultural situations, it is clear that successful entrepreneurs from different situations act on the same basic competencies that are tailored to their specific environments and business characteristics.

The results prove that entrepreneurial competencies can be the basis for the strategy formulation to be competitive in the global market regardless of location. It was observed that there exists a relationship between competitiveness and entrepreneurial competencies among the entrepreneurs who won the business TOP prize and to those American entrepreneurs surveyed. To know how to act is related to both opportunity and conceptual competencies. To know how to mobilize involves management competency and to know how to communicate is related to relationship competency. To know how to compromise and how to take responsibility involves conceptual and compromising competencies. To have strategic vision is related to strategic competency. Finally, to know how to learn is associated with conceptual competency, management, and support competencies.

## REFERENCES

- Bardin, L. (1977). *Análise de conteúdo*. Edições 70 Ltda. Lisboa, Portugal.
- Baron, R. A. and Shane, S. A. (2007), *Empreendedorismo: uma visão do processo*, São Paulo: Thomson Learning.
- Bauer, M. W. and Gaskell, G. (2002). *Pesquisa qualitativa com texto, imagem e som: um manual prático*. Petrópolis, RJ: Vozes.
- Benicio de Melo S. C., Souza Leão, A. L. M. de. and Paiva Junior, F. G. de. (2006, October-December). Competências Empreendedoras de Dirigentes de Empresas Brasileiras de Médio e Grande Porte que atuam em Serviços da Nova Economia, *Revista de Administração Contemporânea*, 10 (4), 47-49.
- Buckley, P. J., Pass, C. L. and Prescott, K. (1988). *Measures of international competitiveness: a critical survey*. J. Mark. Manage, 4 (2), 175-200.
- Day, G. and Reistein, D. (1997). *Dynamic competitive strategy*, New York: John Wiley.
- Dornelas, J. C. A. (2001). *Empreendedorismo: transformando idéias em negócios*, Rio de Janeiro: Campus.

- Dornelas, J. C. A. (2007). *Empreendedorismo na prática: mitos e verdades do empreendedor de sucesso*, Rio de Janeiro: Elsevier.
- Drucker, Peter F. (2005). *Inovação e Espírito Empreendedor (entrepreneurship): prática e princípios*, São Paulo: Pioneira Thomson Learning.
- Dutra, J. S. (2002). *Gestão de Pessoas: modelo, processos, tendência e perspectivas*, São Paulo: Atlas.
- Exame PME/Deloitte. (2007, September-October). EXAME/PME - 100 Pequenas e Médias Empresas que mais crescem, São Paulo: Abril. 10th ed., 26-38.
- Krogh, G. and Roos, J. (1995). A perspective on knowledge, competence and strategy, *Personnel Review*, 24 (3), 56-76.
- GEM 2006. (2007). Global Entrepreneurship Monitor, in Dornelas, J. C. A. *Empreendedorismo na prática: mitos e verdades do empreendedor de sucesso*, Rio de Janeiro: Elsevier.
- Gil A. C. (2002). *Como elaborar projetos de pesquisa*, 4. ed., São Paulo: Atlas.
- Le Boterf, G. (2003). *Desenvolvendo a Competência dos Profissionais*, Porto Alegre: Artmed.
- Man, T. W. Y. and Lau, T. (2000, September). Entrepreneurial competencies of SME Owner/Managers in the Hong Kong Services Sector: a qualitative analysis, *Journal of Enterprising Culture*, 8 (3), 235-254.
- Man, T. W. Y., Lau, T. and Chan, K. F. (2002). The competitiveness of small and medium enterprises: a conceptualization with focus on entrepreneurial competencies, *Journal of Business Venturing*, 17, 123-142.
- Mattar, F. N. (2001). *Pesquisa de Marketing*, 3rd. ed., São Paulo: Atlas.
- Porter, M. E. (1996, November-December). What's strategy? *Harvard Business Review*, 74 (6), 61-78.
- Porter, M. E. 1980). *Competitive advantage: techniques for analyzing industries and competitors*, New York: The Free Press.
- Prahalad, C. K. and Hamel, G. (1990, May-June). The core competence of the corporation, *Harvard Business Review*, 68 (3), 79-91.
- Robbins, S. and Coulter, M. (1998). *Administração*, Rio de Janeiro: Editora Prentice-Hall do Brasil Ltda. 5th ed.
- Salim, C. S., Nasajon, C., Salim, H. and Mariano, S. (2004). *Administração Empreendedora: teoria e prática usando estudos de casos*, Rio de Janeiro: Ed. Campus: Elsevier, Chap. 1, 1-17.
- Schumpeter, J. A. (1982)[1934]. *Teoria do Desenvolvimento Econômico*, São Paulo: Abril Cultural.
- SEBRAE-SP, in Dornelas, J. C. A. (2007). *Empreendedorismo na prática: mitos e verdades do empreendedor de sucesso*, Rio de Janeiro: Elsevier.
- SEBRAE/RJ. (2006). *Instrumento de Avaliação para Micro e Pequenas Empresas*, Rio de Janeiro.

# **FAMILY BUSINESS SUCCESSION: HOW MEN AND WOMEN PREDECESSORS CAN BRING CREDIBILITY TO THEIR SUCCESSORS?**

**Vivi Koffi, University of Moncton  
Izold Guihur, University of Moncton  
Tania Morris, University of Moncton  
G rard Fillion, University of Moncton**

## **ABSTRACT**

*Most family businesses are expected to be transferred to the younger generation within the next 10 years. Among the factors influencing the success of the generational transition is the credibility that must be earned by the successor in the eyes of the employees. Such credibility appears to be the determining factor for ensuring a lasting success of the business. Based on this premise, a comparative study involving seven cases of succession was conducted. The results show that men and women business owners adopt different behavioral strategies in order to bring credibility to their successors.*

## **INTRODUCTION**

Known for their major contribution to economic growth, family businesses represent close to 75% of all entrepreneurship in Canada. They generate about 45% of the Canadian net growth product, create employment for 50% of the labour market, and create each year 70% to 85% of all new jobs (Bruce & Picard, 2005; Deloitte & Touche, 1999). However, according to a study from Bruce and Picard (2006) on Canadian family business predecessors, 41% of them will transfer their business to a successor within the next five years, reaching a proportion of 71% in the upcoming 10 years. And only 35% of family business predecessors say that they have a well-established plan for selling or transferring their business, notwithstanding the fact that the successions are known to be a long and complex process with a very low success rate.

According to numerous authors, successful successions depend on identifiable factors. For some authors, the transition depends not only on the predecessor's will to retire (Lansberg & Astrachan, 1994) or to let go (Bruin de Pontet et al., 2007), but also on the succession planning (Sharma, 2004; St-Cyr & Richer, 2007) and on the successor's preparation and ability to operate the business (Venter et al., 2005). Others identify the predecessor's ability to build a good relationship with the successor (Cabrera-Su rez, 2005; De Massis et al., 2008; Garc a-Alvarez et al., 2002) as a basis for a stable future. Some researchers are more interested in the abilities such as the successor's skills to assume his/her leader's role (Mitchell et al., 2009; Venter et al., 2005),

or in his/her degree of experience (Le Breton-Miller et al., 2004), or even in the successor's commitment, satisfaction, and motivation (De Massis et al., 2008). Finally, some researchers consider that in order a transfer be successful: a) sound and ethical values must be transferred to the successor (García-Alvarez et al., 2002); b) assistance must be provided for the successor's development (Cabrera-Suárez, 2005); c) the successor must be feeling involved into the process (Haberman et al., 2007; Koffi, 2008); and finally, the successor must have credibility (Barach et al., 1988; Bayad & Barbot, 2002).

Despite of the mass of research conducted during the past 30 years on the problem of successions in family businesses, very few researchers have focused on the process of succession when the business owner is a woman, and even less on how she should proceed to set up her successor (Salganikoff, 1990; Sharma, 2004; Sonfield & Lussier, 2009). Particularly since in all likelihood many of the family business predecessors struggling with the difficulties of succession will be women. Indeed, Statistics Canada as well as Industry Canada report that more than 40% of the Canadian entrepreneurs are women (St-Cyr & Richer, 2007). In addition, the entire body of research realized on women entrepreneurship and their leadership style, from the study by Hisrich and Brush in 1984 to those of Buttner in 2001, shows that the behavior of women entrepreneurs towards their personal and business circles differs from those of their male counterparts.

So the specific leadership style and behavior of men and women entrepreneurs and the urgency to support their successors in a successful transfer of their family business is certainly important and relevant as a research topic in itself. Its main objective is to better understand and describe the different behaviors adopted by men and women predecessors of family businesses in transferring credibility to their successor in the eyes of the employees with which they have built their business, especially when credibility appears to be a necessity for the enterprise durability and survival (Barach et al., 1988; Sathé, 1985). In other words, what are the behaviors to be adopted by men and women predecessors to ensure the credibility of their successors? And, what could characterize a credible successor in the eyes of men and women predecessors, employees, and successors?

To answer these questions, the following section briefly presents an analytical framework on the stakes of succession in family businesses. The particularities of the women management style, the transfer process of family businesses, and the concept of successor's credibility are discussed. And the next sections present the methodology used to conduct the study, the results of the study, as well as the conclusion.

## THEORETICAL CONTEXT

### **The Relational Mode of Women Business Predecessors**

There has been no consensus until now on the different management styles adopted by both men and women. For the liberal feminist, men and women are all equal as they are endowed with rationality and the same management capabilities (Hollander, 1992). For the post-structural feminist, however, masculine and feminine identities are a socially constructed phenomenon based on mechanisms of separation and hierarchy-building (Ahl, 2006; Bruin de Pontet et al., 2007; Butler, 1990; Ely & Padavich, 2007). As for the researchers interested in social feminism, they postulate that basic differences exist between men and women. These differences may be at the advantage of women, especially on the basis of interpersonal and communication skills (Chodorow, 1978; Gilligan, 1986). Given the present study seeks to understand the gender particularities, the social feminist view was retained for its contribution to the understanding and distinction of the means used by men and women predecessors in bringing credibility to their successors.

The works from Brush (1992), Buttner (2001), and Robinson (2001), indicate that women entrepreneurs adopt a behavioral style more oriented towards participation. Women entrepreneurs make greater effort than men entrepreneurs do to fit both work and family into their lifestyles. Inversely, men entrepreneurs show their preference for an enterprising mind, and tend to prefer a role of supervision to one of collaboration. According to Eagly et al. (2003) and Rosener (1994), the study of Riebe (2005) on 27 successful business predecessors indicates that women adopted behaviors related to collegiality and democracy in order to be successful. Based on the relational theory (Fletcher, 1999; Miller, 1986), Buttner (2001) did a case study on the behavioral style of women entrepreneurs. Buttner's results show that women entrepreneurs benefit from a sense of connection in order to adopt behaviors promoting the growth and development of individuals. These behaviors can be regrouped into four categories: a) protective, where women entrepreneurs protect and support their employees; b) mutual empowerment, where they try to provide fulfillment for their employees by allowing them to accomplish and contribute to business activities; c) accomplishment, where women entrepreneurs use their relational skills to improve their own professional growth and efficiency at work; and d) team building, where women seek to set up appropriate conditions so that a group lifestyle be flourishing.

As mentioned by Rapoport and Bailyn (1996), as well as Fondas (1997) and Weisinger (1998), Tsui et al. (1997) found that organizations that privileged relational practices were very efficient, showed lower absenteeism and turnover rates, and reported a higher level of honesty. In accordance with these findings, many authors indicate that women adopt, more often than men do, a transformational leadership style that emphasizes the development of individuals (Bass & Avolio, 1994; Eagly et al., 2003; Rosener, 1994). Four characteristics refer to transformational leadership: a) visionary, reflecting the leader who carries a vision; b) inspirational, meaning that

the leader transfers to others high expectations towards his/her vision and passion; c) intellectual stimulation, where the leader appeals to rigorous problem solvers; and d) individual mentoring, meaning that the leader gives to each employee a particular and personal attention. However, how are these behaviors manifested in the context of succession?

### **The Succession in Family Businesses**

Cadieux and Brouard (2009) state that we can speak of transfer only when an enterprise ensures continuity with a successor established by the owner who is retiring. Research indicates three types of transfers: a) a family transfer, while an owner transfers the enterprise to a family member; b) an internal transfer, while an owner transfers the enterprise to one or several non-family members; and c) an outside transfer to another party, while an owner is unsuccessful in finding a family member, or internal member, and has to look outside to choose a successor.

A study on family transfers, known as successions, shows that it is often a two parts process: direction and property transfer (Hugron, 1992). Directional transfer is defined as a dynamic process involving four phases and functions during which the roles and functions of the owner and successor (a family member) are intertwined to ensure a smooth transfer (Handler, 1990). Examples of such roles and functions are one's overall philosophy, management style, responsibility, attitude, power, and leadership potential (Cabrera-Suárez, 2005; Danco, 1982; Hugron, 1987; Lajeunesse, 1989). In the initial phase, the owner introduces the successor to the operations of the enterprise and raises his/her interest. Subsequently, the integration phase allows the successor to have a part time position within the enterprise. At the co-management phase, the successor chosen for his/her competencies and interest (Haddadj & Andria, 2001), and who have a good relationship with all parties (Lansberg & Astrachan, 1994), officially joins the enterprise. The successor familiarises with the company by working alongside the employees and the family owner (Hugron, 1992; Lajeunesse, 1989). At this stage, the successor gains credibility, which is extremely important, as argued by Barach et al. (1988). The owners role, overall, is well defined (Cadieux, 2004) in transferring knowledge, philosophy of life, philosophy of management, responsibilities, and power to the successor (Hugron, 1993; Lajeunesse, 1989), until the business owner retires completely in the phase of disengagement. On the other hand, according to Barach et al. (1988), what credibility allows the successor to guide the enterprise in an autonomous way without managerial difficulties? And how is this credibility acquired?

### **The Successor's Credibility**

There is not yet a consensus on the conceptual definition of credibility (Gradwell, 2004). In general, credibility refers to how a leader gains trust and commitment from the personnel on common projects (Budd, 2000; Gradwell, 2004; Schuler, 2004). According to Kouzes and Posner (2004), the personal or professional qualities admired most and viewed as credible for a superior



are, in order of importance: honesty, competency, inspirational, and goal-oriented for the future. Barach et al. (1988) and Sathe (1985) argue that a successor is viewed as credible when employees and/or colleagues perceive his/her intention and capacity to achieve broad or wide-ranging results.

Sathe (1985) indicates that the stability and performance of the enterprise is determined by the level of credibility shown by the successor. If a successor's competencies are not recognized or accepted by the organization members, his/her leadership within the enterprise will fail.

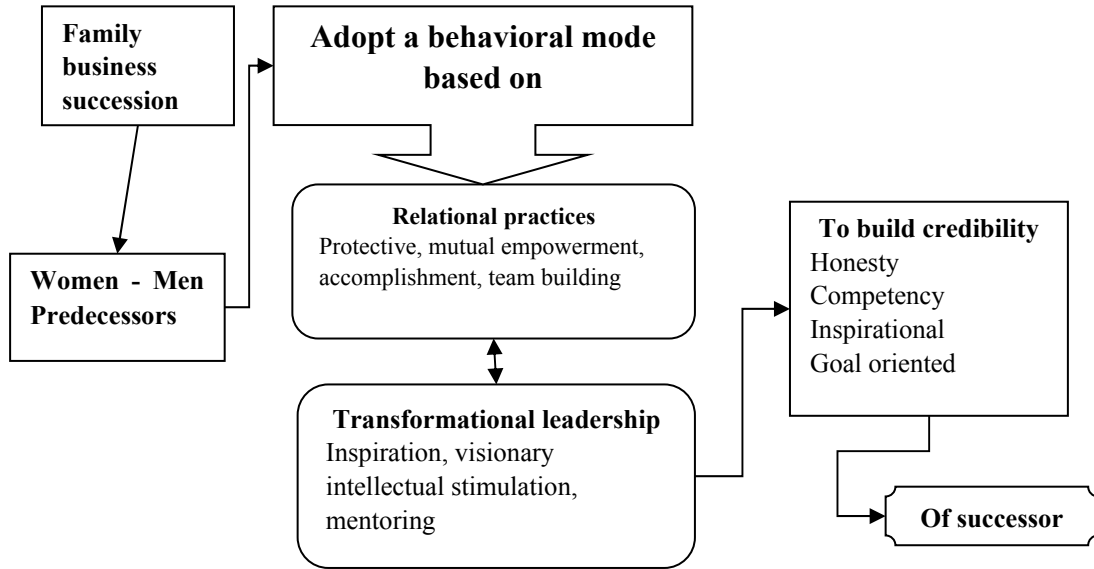
In sum, it should be noted that the literature on family businesses does not clearly indicate the behavioral strategies adopted by predecessors to enhance their successors' credibility in the eyes of their employees; and even less when regarding the distinction of such strategies between men and women predecessors. However, research from social feminists, most particularly from the relational theory and the transactional and transformational leaders, supposes that the tendency of women entrepreneurs to link with others and to favour the development of employees could bring woman predecessors to adopt distinct behaviors supporting the rapid development and credibility of their successor. Based on this approach, and as suggested by the conceptual model on Figure 1, men and women predecessors adopt distinct behavioral modes, based on their relational practices and their transformational and transactional leadership (Bass & Avolio, 1994, Eagly et al., 2003) in order to bring credibility to their successor. If this is the case, the question then becomes a matter of identifying what types of behavior are to be adopted by the majority of the family business predecessors. The research methodology presented in the following section should allow us to answer this important question.

## METHODOLOGY

### Sample

In order to understand the behavioral methods adopted by the predecessors to enable their successors to gain credibility by their enterprise members, we opted for a qualitative research methodology guided by a strategy of multi-site<sup>1</sup> descriptive studies. The theoretical sampling<sup>2</sup>, deliberately chosen<sup>3</sup>, was retained while taking into account the following sampling criteria: initiating the process of succession from the first to the second generation, potentially at an end; succession from the mother or father to daughter or son; company in the manufacturing or the services sector, with 10 to 250 employees; employee retained having worked for the company with the owner-manager before or while the successor is introduced into the company (see Table 1).

**Figure 1: Relationship between the Behaviors of Men and Women Predecessors, and the Successor’s Credibility**



## RESULTS

How do predecessors decide, at the end of their careers, to retire and leave the company that they created and built to their chosen successor and ensure that the latter is viewed as a credible choice? That is the question! In trying to answer this question, we turn to the speeches provided by the predecessors. In a comparative perspective, first, we will describe the leadership behaviors according to whether the predecessor is either male or female, for the credibility of the successors. And we will determine if there is a difference in these behaviors, which we categorize under the theme “leadership strategies”, and then analysed relationally to those factors under the theme “credibility”.

### Comparative Analysis: Similarities between Men and Women

The comparative analysis of behaviors resulting from the different styles of predecessors indicates that there are more differences than similarities. The only behavior adopted by both men and women to help their successor to be accepted is the accreditation of the latter. In other words, in order to allow their successors to gain credibility, given that they have their own individual past and that they took different paths in creating and managing their business, the four women predecessors distinguished from their male counterparts by helping their successors to gain credibility following a linear process (see Figure 2). In fact, they made their choice of successor

based on confidence, organized to inspire them, putting an accent on teamwork, in the whole, adopting a style that we call “maternal” leadership. As for the men predecessors, while controlling their successors, they would have to prove their worth, to be their source of inspiration, and to put an emphasis on the dyadic type of work. So in what follows, first, we present the common behaviors of men and women, that is, the process of accreditation. Second, we discuss about the distinctive behaviors of both. Finally, we describe the “acceptance” process of the participants.

<b>Women Predecessors</b>	<b>Nature</b>	<b>Montage</b>	<b>Terroir</b>	<b>Binette</b>	
<b>Founding date</b>	1987	1988	1991	1986	
<b>Sector of activity</b>	Services	Services	Manufacturing	Services	
<b>Number of employees</b>	59	50 to 150	32	26	
<b>Successor</b>	Daughter	Son	Son	Son	
<b>Turnover</b>	3 to 4 millions	2 to 3 millions	3 millions	6 to 7 millions	
<b>State of transfer</b>	Completed	Dual management	Completed	In progress	
<b>Actions</b>	Predecessor: 0% Successor: 33% Shareholders: 66%	Predecessor: 33% Successor: 0% Shareholders: 66%	Predecessor: 52% Successor: 48%	Predecessor: 50% Successors: Son: 25% Daughter: 25%	
<b>Interviews</b>	3 interviews	4 interviews	4 interviews	4 interviews	
<b>Men Predecessors</b>	<b>Cérami</b>	<b>Sanite</b>	<b>Jetpur</b>	<b>Chocolat</b>	<b>Atti</b>
<b>Founding date</b>	1975	1980	1999	1978	1981
<b>Sector of activity</b>	Retail commerce	Services	Manufacturing	Services	Manufacturing
<b>Number of employees</b>	15	20	46	25	35
<b>Successors</b>	Daughter	Son	Daughter	Daughter	Son
<b>Turnover</b>	2 millions	6 millions	5 millions	4 millions	10 millions
<b>State of transfer</b>	Almost completed	In progress	In progress	In progress	In progress
<b>Actions</b>	Predecessor: 100%	Predecessor: 100%	Predecessor: 63% Successor: 6% 3 employees: 31%	Predecessor: 100%	Predecessor: 100%
<b>Interviews</b>	4 interviews	4 interviews	4 interviews	4 interviews	4 interviews

### **Accreditation to Reinforce Competencies and Credibility**

By accrediting their successors, men and women predecessors have applied by ensuring that the former are capable of achieving the objectives related to the responsibilities that have been given. They accentuate both internal and external training. Even if the accreditation is important to both genders, they do not proceed in the same manner. Regarding the training of the successors within the company, the four women favored to train their successors in a more tacit manner by mentoring and coaching, which was undertaken very often by employees, either with outside help or consultants. The predecessors also knew how to develop in their successors not only the ability to well manage special projects, but also using a training based on openness and

empathy thus sharpening the abilities of their successor to be both experts and apprentices able to question and to be inquisitive. Following are some comments of the participants.

*“Ignace must recognize his weaknesses and learn” (Predecessor, Montagne). “She taught me to validate much more regularly, even if I know how to do it. I must say that, in her opinion, one must never say we know too much. Rather we must always learn from others” (Successor, Binette). As for special projects: “The first thing I did was prepare the specifications, then share the principal responsibilities” (Successor, Montage). “It goes well, already it is starting to show improvements in human resources, and job descriptions are better defined. It is Anthony’s job!” (Resource person, Binette).*

Proceeding in about the same manner as women owners, the men predecessors found it important to ensure that their successor acquires different knowledge and training from both inside and outside, as well as gains experience by means of special projects within the company. However, on the contrary of women, who preferred to include consultants to finalize the transfer of knowledge, men predecessors put an emphasis on the niche offered by tacit training within the company. This training approach allows the successor to learn, while watching if the mentor, in this case, often the predecessor or some coaches or assistants, proceed in a concrete manner.

*“Yes, yes, 100% credible, competent, honest, and ethical. This is of a great value for us” (Resource person, Cérami). “Yes, special projects allow to gain more credibility in the eyes of the employees [...]. In fact, each project which is successfully completed contributes, I think, to get a certain amount of credibility” (Successor, Jetpur). “Before, I would give him considerable advice and I was unrelenting” (Predecessor, Cérami). “Meanwhile, his father was also there advising and showing him how to proceed” (Resource person, Cérami).*

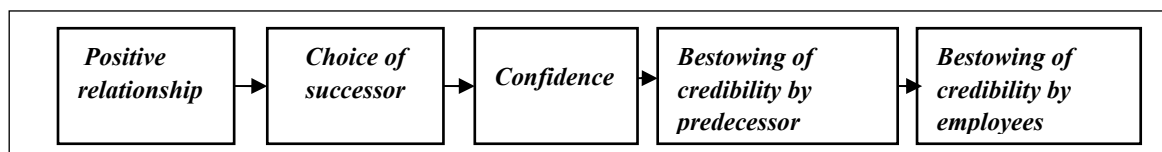
### **Have confidence in the successors**

A particular behavior that stands out from the thematic analysis and that characterizes all of the four women is their ease in bestowing confidence. Based on the good relationships that the predecessors maintained on a confidence basis with their successor, the four women first made the choice of successor while the latter clearly indicated the desire to integrate the family company and to take it in charge. The predecessors then applied themselves to build upon this confidence in such a way that the employees, in turn, demonstrated their confidence quite naturally towards the successor. This turns out to be a fundamental element of credibility (see Figure 2). To that end, the first action taken as the successors began working was to delegate

them, without hesitation, particular tasks matching the authority level they had to properly function. Sometimes, when faced with responsibilities for which they had few or no abilities, the women predecessors were convinced that they would eventually learn, knowing that the successors could make some errors. They were often insignificant thus putting the accent on tolerance for mistakes. For example, when the predecessor of Nature says to her successor “You are the one who must now take the lead, go ahead!” without any concern for lapses that her daughter may have, she is essentially telling her to no longer doubt about herself and instead have confidence thereby gaining credibility as well. The predecessors respected their successor, increased their visibility both within and outside the company, and praised their merit from the employees and even the suppliers, while expressing their pride, which all contributes enormously to their credibility.

### Which Behaviors Are Best Suited for Women Owners of a Company?

**Figure 2: Linear Model: Women Predecessors and Successors’ Credibility**



*“Ignace now has a much greater presence here because Mrs. Guimond gives him more leeway” (Resource person, Montage). “She has confidence in him. He is the one who makes the big decisions and it reinforces his credibility” (Resource person, Terroir). “I think that it is because I always respected Liette, and her inner self, that in turn it helped increase both their confidence and her own personal credibility” (Predecessor, Nature). “My mother has total confidence in me and I wonder how she does it?” (Successor, Binette).*

### Inspire the successors

The predecessors are considered as role models for the successors given their passion, tenacity, and zeal at work. They put everything into their work to instill their vision and share it with successors and employees.

*“I admire my mother because she succeeded in the affairs of her company despite of a businessman’s milieu. Is this a role model? Yes, certainly it is! One of her best practices consists of having a clear vision” (Successor,*

*Terroir*). “I am an example for her to follow. I must show her my tenaciousness in achieving a great quality work” (Predecessor, Nature). “All of these qualities that you see, she gave them to Anthony. Accordingly, she is a model for all of us” (Resource person, Binette). “She transferred her vision to him” (Resource person, Montage).

### **Practice maternal leadership**

The predecessors adopted an empathetic behavior in the sense that they knew how to make, with tact and gentleness, the bridge between the rational and the emotional to reach their successors to face the organizational resistance, especially without frustrating the employees.

*“When there is a conflict, we try to ensure that the exchange is not too public. Almost always, we discuss about it either in my office or elsewhere” (Successor, Binette). “Mrs. Duperré is a woman who knows how to listen” (Resource person, Nature). “When I often ask particular men for advice, they think that I am too protective” (Predecessor, Montage).*

### **Work in collaboration**

When predecessors express their confidence in their successor by granting him/her of a considerable latitude, they also count very often on teamwork, created in part on a social and professional interdependence where a failure for someone is automatically a failure for the others. Two predecessors created teamwork and named their successors team managers.

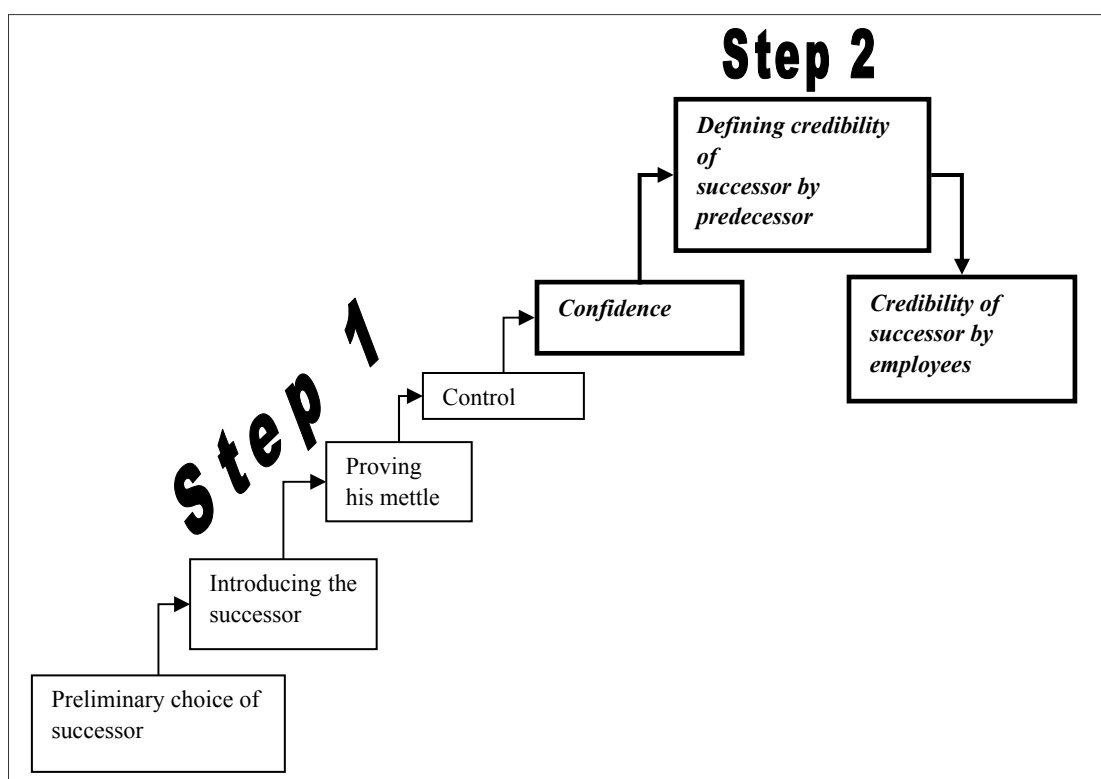
*“The spa is everyone’s business. You’re either in or out, teamwork is essential” (Resource person, Nature). “We work together for that vision. We are all part of the team, not just the three members of the family. My mother was telling me I am now the chief of the team” (Successor, Montage). “Teamwork is very strong here. An employee was fired because he could not get along with others” (Predecessor, Terroir). “Absolutely, we have the spirit to help others” (Resource person, Binette).*

### **The Behaviors of Men Predecessors**

Four of the five predecessors helped their successors to gain credibility according to a process that took place in two steps (see Figure 3). Once the choice of successor has been made, credibility was not granted automatically. The predecessor, presenting himself as a role model to imitate, requires the successor to make proof before he bestows his confidence; consequently, it is only at this moment that the employees acknowledge their confidence and credibility in him.

Thus, the following measures take place: a) inspiring the successor; b) accrediting; c) exercising control; and especially d) not working as a team as women predecessors, but holding dyadic meetings with the successor. Only one of the predecessors insists on teamwork.

**Figure 3: Two-Step Model of the Successor's Credibility Process by Men Predecessors**



### Inspire

Like women, men predecessors are considered relentless workers who inspire their successors, serve as a role model, and who convinces successors to embrace the vision of the company, which in turn favours their credibility. The only difference, when compared to women, stems from the fact that fathers are, with few exceptions, dominant role models to follow; in other words, the first ahead of their colleagues or coaches.

*“I saw my father work flat out all his life and I am doing the same. Unlike others, he came first and I had his confidence, improving my credibility” (Successor, Cérami). “Certainly Andy served as an example for me all my life, even indirectly, it has an effect on my being there. I always saw his management style and I adopted this style myself” (Successor, Sanite).*

### **Make his/her Proofs**

Contrary to women successors, successors from men predecessors are required, once the process of accreditation is completed, to prove their mettle by assuming the responsibilities they are conferred to them. It is only at this stage that the predecessor will acknowledge having confidence in the successor and at which point they will gain the credibility of employees to the extent of their predecessor.

*“At one time, me, the accountant, and the treasurer said: That’s it, Michel, stop, or she will have a burn-out. It will not help if she falls ill, even though she has fallen a bit ill” (Resource person, Jetpur). “I think that he is taking a bit too much on his shoulders for the moment, perhaps not to the point of distress, but fatigue” (Resource person, Sanite). “I think I went too far to prove myself because I knew he is proud and did not want to lose face; afterwards, he could have faith in me” (Successor, Cérami).*

### **Control**

Contrary to women predecessors who leave their place to their successors by having total confidence in them, men predecessors who leave responsibilities to their successors for certain activities still ultimately retain control in order to meet the objectives and to see improvements in the ways of their successors. This way of doing allows the successor to gain credibility, after completing the typical special projects.

*“He is a very hard man, Mr. Garneau, he wants to control everything [...] and even at his age, he is here, sitting right over there” (Resource person, Cérami). “He comes over to watch what transpires. Being here, Mr. Sanite is still with us, and still in charge!” (Resource person, Sanite).*

### **Dyadic Work**

Tasks at work between predecessor and successor often continue at two, either as teamwork or as dyadic work.

### **Comparative Analysis of Credibility Factors for Men and Women**

Regarding the credibility factors outlined in Table 2, we can also state that according to the participants of companies managed by women, in order to be seen as credible, successors



must be perceived as, in order of importance, managers worthy of confidence, honest, highly competent, and especially must demonstrate value added competency. When companies are managed by men, successors must demonstrate value added competencies, make a difference by handling special projects, gain the confidence of employees, and demonstrate honesty. Women are more inclined to confer responsibilities to successors by believing in their abilities to assume them. This behavior helps employees bestow their own credibility. Men predecessors, however, require successors to prove and to demonstrate to employees that they are competent and worthy of confidence.

<b>Table 2: Comparison: Credibility Factors for Men and Women</b>		
<b>Credibility</b>	<b>Women</b>	<b>Men</b>
Confidence	Importance accorded to gain in confidence	Not as important compared to women
Honesty	Importance accorded to honesty	At first, it does not seem important
Special projects	Because they are based on the competencies of successors	To demonstrate abilities and make a difference
Value added competencies	Unique competencies that lead to better management	Specialized and unique competencies show “added value”
<b>Women:</b> They are more inclined to confer responsibilities to successors by believing in their abilities to assume them and such behavior convinces employees to accord them credibility.		
<b>Men:</b> Successors must prove to employees that they are capable and worthy of confidence.		

## **DISCUSSION AND CONCLUSION**

How do owner-managers of family doing businesses to decide, at the end of their careers, to retire and transfer their company to their children to ensure that their chosen successor is viewed with credibility by the employees of the company, one that they created and built with their own hands? That is the question we asked ourselves.

We think that this research reached its objective because it allowed us to describe and understand the winning behaviors of women and men owner-managers who worked to ensure the credibility of their successor in the eyes of their employees, something that was never before examined.

The study on leadership behaviors led us to apply the transformational leadership theory by Bass and Avolio (1994) and the relational theory by Buttner (2001) since these models, which are not exclusive to women, can serve as a reference framework in the behavioral study of women and men entrepreneurs at work. We note that even if, according to Buttner (2001), this relational framework with four fundamental factors is perfectly adapted to the study of women entrepreneurs, nonetheless, we have found all the factors of this framework from the group of

women in our study. Our results indicate an improvement of this relational model by other factors that emerged during our analysis. Thus, when we say family SMB managed by women, factors such as confidence, “maternal leadership”, and teamwork can be presented. It is important to mention that even if we can assume that these factors are adaptable to men, since according to Buttner (2001) the relational framework is not uniquely identified with women, these factors certainly do not all apply in the case of men, or in some instances, at least not in the same manner. Consequently, we should, if it is possible, disassociate the leadership of women from those of men. At the very least, this would merit to be examined in future studies.

The results show us that, in the case of women, the effort to establish good relationships with their successor and especially to have confidence in them automatically drive the employees to have confidence in them and to give to the successor the credibility. This leads us to an important consideration in the successful transmission: the social contagion of owner-managers to their employees. In the case of women, it is not only confidence that constitutes the foundation of credibility, but also an indicator of the success in transmitting such values, as stated by Barach et al. (1988), Koffi and Lorrain (2011), and Sathe (1985). This confirms the importance of a positive relationship between parents and children, as mentioned by some authors in their studies (Cabrera-Suárez, 2005; De Massis et al., 2008; García-Álvarez et al., 2002; Miller et al., 2003, Venter et al., 2005). Hence, for a good reason, the study conducted by Lorrain et al. (2005) concludes that men predecessors who have not confidence in their successors experience difficulty in judiciously reassuring their chosen replacement. Cadieux et al. (2002) indicate, in this way, that the rapport between women-mother entrepreneurs and their children are usually different because their relationships are less tense than those of men-father entrepreneurs and their respective children. Women owners better understand their children and their potential, thereby giving them more credit.

Considering that women give their confidence without asking too many questions and adopt a maternal style in accreditation and teamwork, does this not confirm their propensity to be maternal, as Gilligan (1986) and Buttner (2001) point out? Or still, can it be explained by Bruin de Pontet et al. (2007), Ely and Padavich (2007), Constantinidis (2010), and Cornet et al. (2008), who viewed the difference between male and female genders as a socially engineered phenomenon and that the realities of women and men are more likely differentiated in a distinct fashion by our society? Since gender and power involving relationships are thus characterized by separation and a hierarchical structure between the genders and is reflected in the enhanced value of the male gender, is masculinity characterized by a quasi-absence of emotion in relationships and the control of situations in which men find themselves?

When we examine accreditation, we also note that some authors (Barach et al., 1988; Fiegenger et al., 1996; Kouze & Posner, 2004; Mitchell et al., 2009; Sathe, 1985; Venter et al., 2005) mentioned that the predecessors consider that the successor must be competent to be seen as credible. Our results also add that women have especially accorded importance to “making a difference” with special projects albeit quietly, and by adopting a “maternal” style in a setting

where initiative and creativity are encouraged. These facts corroborate the results of Mitchell et al. (2009) which emphasize the qualities of the successor, and the necessary manoeuvring room to grant him as part of the scope of his workplace introduction.

Even though for men predecessors, earning credibility first started with proving oneself and then being in charge before bestowing confidence, women predecessors preferred teamwork that puts to good use of what participants call social and professional interdependence. This was not the case for men. This concept of teamwork sheds an important light on the commitment and feeling of belonging that women created and which we do not find in the literature. The effect of putting successors in touch with new and better ways to manage, such as mutual support and better communication, alongside experts and colleagues at work, is shared by Buttner (2001), Fletcher (1999), and Salganicoff (1990), who argue that women having a mutual sense of protection and development would therefore be inclined to give their best, while having the business skills and the will to switch, in the best interest of their employees, the role of expert for the role of apprentice. On the other hand, is it because, as stated by Ahl (2006) and Ely and Padavich (2007), they are conditioned to adopt managerial behaviors which are considered feminine?

It remains true, according to our study, that gaining credibility, and therefore indirectly succeeding in a family succession, remains in large part in the way it is done, since all women predecessors have succeeded in transferring their business! This reinforces what we have noted regarding the degree of difference between the style of leadership of men and women entrepreneurs. We hypothesized it in our problematic, however, for the first time, even if we have a limited number of case studies, our results bring an empirical support to this differentiation, clearly and newly shown, between women and men entrepreneurs in the context of a succession in a family owned SMB in Quebec. This brings us to formulate the hypothesis according to which the success rate in a succession will be considerably higher with women entrepreneurs at retirement than with men because women would: a) shoulder; b) have business sense; c) act maternally; d) inspire; e) have confidence; f) accentuate teamwork; and g) entertain harmonious relations with their successors. They would spontaneously offer their support, which is not the case for men, because as far as they are concerned, at least those who were part of our sample, the process takes place in two stages: the successor must first be accepted as credible by the father before the employees are viewing him with credibility.

### **Lessons Learned and Implications for a Successful Succession**

From a scientific point of view, approach the problematic of a succession from the angle of women entrepreneurs; moreover, from the angle of a comparative study on men and women, this is now recognized as a fact. The subject matter is of little interest to researchers. In addition, the literature describing the qualities of women and men entrepreneurs are too much oriented towards generalities by representing women as collaborative, participatory, and transformational,

and representing men as combative, competitive, and transactional, without even proposing theoretical models and validating empirical data. Our study succeeded in doing that, because the behaviors adopted by predecessors with regard to the credibility of their successors seems to be a winning formula and well rooted in the female gender. From a practical point of view, the phenomenon of social contagion on the relationship and confidence level is very fundamental in realizing the succession. Our study could help predecessors to improve their relational approach with their successors and have confidence in them. Consultants who offer advice on behalf of business owners should necessarily: adapt their discussion, their approach, and the tools they use to assist predecessors. Considering that women predecessors seem to adopt a style that is more “maternal” and more feminine, will men predecessors do the same? Consultants should initiate workshops to sensitize and plan new strategies modeled on the winning behaviors of women, use appropriate reference frameworks, for with such an omission, they could encounter problems with women predecessors who will not recognize themselves in the male models.

Despite the contribution of this research, it is important to highlight its limitations. Principally, the limited number of case studies, the possibility of bias in the answers provided by participants in interviews, and research limitations in analysing a vast amount of data. It seems important in future research to undertake a comparative study (men-women) in order to see whether there is a difference in the behaviors adopted by successors during the credibility process. Finally, this research clearly demonstrates the great interest to pursue the work on the process of succession when family-owned businesses are managed by a woman.

## ENDNOTES

- 1 The case study is preferred because the phenomenon is part of a new problematic for which few empirical studies have been conducted (Grenier & Josserand, 1999), therefore cannot exist except in the context in which it evolves (Yin, 1994). In addition, multi-sites take into account numerous cases (four in the present study) considered by Hlady-Rispal (2002) as sites.
- 2 The seven cases are chosen for theoretical and not statistical reasons (Hlady-Rispal, 2002).
- 3 The rarity of women enterprise owners in a managerial transfer situation deliberately forced us to choose participants who, at the end, were found willing to allow for the comprehension and the interpretation of the leadership behaviors that they adopt for their successor’s credibility.
- 4 The three-interview formula was structured around the following topics: introducing the company, the process of succession, the process of transferring competencies, leadership behaviors, and the credibility of successors.
- 5 The triangulation of data allows us to compare data collected from different sources in order to have more robust results (in this case, predecessor, successor, the two employees and documentation obtained from each company).
- 6 The basis for the analysis in QSR Nvivo 2.0 software refers to what Tesch (1990) describes as an initiative to de-contextualize-re-contextualize from the main body. This de-contextualization consists of removing from the context an excerpt of the speech in order to present it as semantically independent in order to create categories or themes that group all the excerpts of a particular subject (Deschenaux & Bourdon, 2005).

- 7 The thematic analysis allows us to proceed systematically a) with the selection, b) the grouping, and c) in addition to examine the rational of the themes discussed in our corpus by reconstructing a new structure with the excerpts grouped by theme or codified, which we used to support the final results.
- 8 To satisfy the requirements of corroborating the data, (Yin, 1994), we compared the different points of view expressed by the participants on a particular subject.

## REFERENCES

- Ahl, H. (2006). Why research on women entrepreneurs need new directions. *Entrepreneurship Theory and Practice*, 30(5), 595-623.
- Barach, J.A., Ganitsky, J., Carson, J.A. & Doochin, B.A. (1988). Entry of the next generation: Strategic challenge for family business. *Journal of Small Business Management*, 26(2), 49-56.
- Bass, B.M. & Avolio, B.T. (1994). Shatter the glass ceiling: women may make better managers. *Human Resources Management*, 33(4), 549-560.
- Bayad, M. & Barbot, M.-C. (2002). Proposition d'un modèle de succession dans les PME familiales : étude de cas exploratoire de la relation père-fille. In *Actes du sixième congrès international francophone sur la PME*, Montréal, 30 octobre au 1 novembre 2002.
- Bruce, D. & Picard, D. (2005). La relève, la clé de la réussite : la relève des PME et la prospérité économique au Canada, <http://www.fcei.ca/researchf/reports/tr3007f.pdf>, accessed 27 may 2013.
- Bruin de Pontet, A., Brush, C. & Welter, F. (2007). Advancing a framework for coherent research on women's entrepreneurship. *Entrepreneurship Theory and Practice*, 31(3), 323-340.
- Brush, C. (1992). Research on women business owners: Past trends, a new perspective and future directions. *Entrepreneurship Theory and Practice*, 16(4), 5-30.
- Budd, J.F., Jr. (2000). The incredible credibility dilemma. *Public Relations Quarterly*, 45(3), 22-26.
- Butler, J. (1990). *Gender trouble: Feminism and the subversion of identity*. London, New York: Routledge.
- Buttner, E.H. (2001). Examining female entrepreneurs' management style: an application of a relational. *Journal of Business Ethics*, 29, 253-269.
- Cabrera-Suárez, K. (2005). Leadership transfer and the successor's development in the family firm. *Leadership Quarterly*, 16(1), 71-83.
- Cadieux, L. (2004). *La succession dans les entreprises familiales : une étude de cas sur le processus de désengagement du prédécesseur*. Thèse de doctorat, Université du Québec à Trois-Rivières, Trois-Rivières, Québec.
- Cadieux, L., Lorrain, J. & Hugron, P. (2002). La succession dans les entreprises familiales dirigées par les femmes : une problématique en quête de chercheurs. *Revue Internationale PME*, 15(1), 115-130.
- Cadieux, L. & Brouard, F. (2009). *La transmission des PME : perspectives et enjeux*. Québec : Presses de l'Université du Québec.
- Chodorow, N. (1978). *The reproduction of mothering*. University of California Press.
- Constantinidis, C. (2010). Entreprise familiale et genre : les enjeux de la succession pour les filles. *Revue française de gestion*, 200, 143-159.
- Cornet A., Laufer, J. & Belghiti-Mahut, S. (2008). *GRH et genre : les défis de l'égalité hommes-femmes*. Paris: Vuibert.
- Danco, L.A. (1982). *Beyond survival: A business owner's guide for success* (3rd ed.). Cleveland, OH: University Press.
- Deloitte & Touche (1999). *Les entreprises familiales canadiennes sont-elles une espèce en voie de disparition?* [www.deloitte.ca/fr/pubs/tax/familybus/survey\\_f.pdf](http://www.deloitte.ca/fr/pubs/tax/familybus/survey_f.pdf), accessed 28 november 2004.

- De Massis, A., Chua, J.H. & Chrisman, J.J. (2008), Factors preventing intra-family succession. *Family Business Review*, 21, 183-199.
- Deschenaux, F. & Bourdon, S. (2005). Introduction à l'analyse qualitative informatisée à l'aide du logiciel QSR Nvivo 2.0. Les cahiers pédagogiques de l'Association pour la recherche qualitative, Sherbrooke, Québec.
- Eagly, A.H., Johannesen-Schmidt, M.-C. & van Engen, M.L. (2003). Transformational, transactional, and laissez-leadership styles: A meta-analysis comparing women and men. *Psychological Bulletin*, 129(4), 569-591.
- Ely, R. & Padavich, I. (2007). A feminist analysis of organizational research on sex differences. *Academy of Management Review*, 32(4), 1121-1143.
- Fiegenger, M.K., Brown, B.M., Prince, R. All. & File, K.M. (1996). Passing on strategic vision: favored modes of successor preparation by CEOs of family and nonfamily firms. *Journal of Small Business Management*, 34(3), 15-26.
- Fletcher, J. (1999). *Disappearing acts: Gender, power, and relational practice in the work place*. MIT Press.
- Fondas, N. (1997). Feminization unveiled: Management qualities in contemporary writings. *Academy of Management Review*, 22(1), 257-282.
- Garcia-Alvarez E, Lopez-Sintas, J. & Saldana Gonzalvo, P. (2002), Socialization patterns of successors in first- to second-generation family businesses. *Family Business Review*, 5(3), 189.
- Gilligan, C. (1986). *Une si grande différence*. Flammarion.
- Gradwell, S.-S. (2004). *Communicating planned change: a case study of leadership credibility*. Thèse de doctorat. Ann Arbor, MI: ProQuest Information and Learning Company.
- Grenier, C. & Josserand, E. (1999). Recherche sur le contenu et recherche sur le processus. In R.-A. Thiétart (dir.). *Méthodes de recherche en management* (pp. 104-136), Dunod.
- Haberman, H., Sharon, M. & Danes, S.M. (2007). Father-daughter and father-son family business management transfer comparison: Family FIRO model application. *Family Business Review*, 20(2), 163.
- Haddadj, S. & Andria, A. (2001). Mesurer les phénomènes agissant sur la transmission des PME familiales. *Revue Française de Gestion*, 132, 11-22.
- Handler, W.C. (1990). Succession in family firms: A mutual role adjustment between entrepreneur and next-generation family members. *Entrepreneurship Theory and Practice*, 15(1), 37-51.
- Hisrich, R. & Brush, C. (1984). The women entrepreneur: Management skills and business problems. *Journal of Small Business Management*, 22(1), 30-37.
- Hlady-Rispal, M. (2002). *La méthode des cas : application à la recherche en gestion*. De Boeck Université.
- Hollander, E. (1992). The essential independence of leadership and followership. *Current Directions in Psychological Science*, 1(2), 71-75.
- Hugron, P. (1987). *Succession managériale dans les PME familiales au Québec*. Monographie. Montréal, QC: Institut de recherches politiques et les Presses HEC.
- Hugron, P. (1992). *L'entreprise familiale. Modèle de réussite du processus successoral*. Monographie, Institut de recherches politiques et les Presses HEC.
- Hugron, P. (1993). *L'entrepreneur et la succession d'entreprise : analyse de douze processus* (1985). (Cahier de recherche sur les entreprises familiales no. GREF-93-03). École des Hautes Études Commerciales, Montréal, Québec.
- Koffi, V. (2008). *L'intégration du successeur dans les PME familiales : une étude de cas comparative des stratégies des prédécesseuses et des prédécesseurs*. Thèse de doctorat inédite. Trois-Rivières, Université du Québec à Trois-Rivières.
- Koffi, V. & Lorrain, J. (2011). Comment des femmes à la tête de PME réussissent-elles leur succession ? *Revue internationale de gestion*, 36(1), 35-40.
- Kouzes, J.M. & Posner, B.Z. (2004). *Les 10 pratiques des leaders mobilisateurs*. Actualisation inc.
- Lajeunesse, C. (1989). *La succession managériale dans la PME familiale : études de règne-conjoint*. Mémoire de maîtrise, École des Hautes Études Commerciales, Montréal, Québec.

- 
- Lansberg, I. & Astrachan, J.H. (1994). Influence of family relationships on succession planning and training: The importance of mediating factors. *Family Business Review*, 7(1), 39-59.
- Le Breton-Miller, I., Miller, D. & Steier, L. (2004). Toward an integrative model of effective FOB succession. *Entrepreneurship Theory and Practice*, 28, 305-328.
- Miller, J.B. (1986). *Toward a new psychology of women* (2<sup>e</sup> éd.). Boston, MA: Beacon Press.
- Miller, D., Steier, L. & Le Breton-Miller, I. (2003). Lost in time: Intergenerational succession, change, and failure in family business. *Journal of Business Venturing*, 18(4), 513-531.
- Mitchell, J.R., Hart, T.A., Valcea, S. & Townsend, D.M. (2009). Becoming the boss: Discretion and postsuccession success in family firms. *Entrepreneurship Theory and Practice*, 33(6), 1201-1218.
- Paillé, P. & Mucchielli, A. (2003). *L'analyse qualitative en sciences humaines et sociales*. Armand Colin.
- Rapoport, R. & Bailyn, L. (1996). Relinking life and work: Toward a better future. *A Ford foundation report*.
- Riebe, M. (2005). The leadership style of women entrepreneurs: an alternative model of successful management practices. *Actes du 50<sup>e</sup> congrès international de l'ICSB*, Washington, 16-18 mai 2005.
- Robinson, S. (2001). An examination of entrepreneurial motives and their influence on the way rural women small business owners manage their employees. *Journal of Developmental Entrepreneurship*, 6(2), 151-167.
- Rosener, J. (1994). Ways women lead. In Nancy A. Nichols. *Reach for the top* (p.13-22), Harvard University School Press.
- Salganicoff, M. (1990). Women in family business: Challenges and opportunities. *Family Business Review*, 3(2), 125-137.
- Sathe, V. (1985). *Culture and related corporate realities*. Irwing Inc.
- Schuler, D. (2004). *The development of credibility between superintendents and their administrative teams*. Thèse de doctorat, Université du Wisconsin-Madison.
- Sharma, P. (2004). An overview of the field of family business studies: Current status and directions for the future. *Family Business Review*, 17(1), 1-36.
- Sonfield, M.C. & Lussier, R.N. (2009). Gender in family business ownership and management: A six-country analysis. *International Journal of Gender and Entrepreneurship*, 1(2), 96-117.
- St-Cyr, L. & Richer, F. (2007). *L'entrepreneuriat féminin au Québec. Dix études de cas*. Presses de l'Université de Montréal.
- Tesch, R. (1990). *Qualitative research: Analysis types and software tools*. Bristol, PA: Falmer.
- Tsui, A., Pearce, S.J., Porter, L. & Tripoli, A. (1997). Alternative approaches to the employee-organization relationship: Does investment in employees pay off? *Academy of Management Journal*, 40, 1089-1121.
- Venter, E., Boshoff, C. & Maas, G. (2005). The influence of successor-related factors on the succession process in small and medium-sized family businesses. *Family Business Review*, 18(4), 283-303.
- Weisinger, H. (1998). *Emotional intelligence at work*. San Francisco, CA: Jossey-Bass.
- Yin, R.K. (1994). *Case study research, design and methods*. Applied Social Research Methods Series, 5 (2<sup>e</sup> éd.), Sage Publications.





# CLLOUD COMPUTING’S SELECTION AND EFFECT ON SMALL BUSINESS

**Don B. Bradley III, University of Central Arkansas**  
**Joel Cooper, University of Central Arkansas**

## ABSTRACT

*This paper is written to help the small business owner understand, select and effectively use Cloud Computing. Common hardware used by small businesses would include the computer and smartphones. By the use of Cloud Computing, the small business should thrive on the new technology that can help them increase their customer base and profitability. The use of Cloud Computing is part of the new wave of technology-based marketing. Currently, there are three different forms of Cloud Computing: Software as a Service (SaaS), Platform as a Service (PaaS), and Infrastructure as a Service (IaaS).*

Cloud computing, by definition, is Internet-based computing; whereby shared resources, software and information are provided to customers and other devices on-demand, like a public utility. Many small businesses today can take advantage of the Cloud to reduce spending on IT, adapt quickly to the changing market, change scale and lower risk and cost. Thanks to the ease of access and ease of use, Cloud computing costs very little when compared to hosting the services yourself. The CTO of Bick Group, David Linthicum, a company that runs Cloud computing services, wrote a book about the benefits of Cloud computing. Cloud Computing and SOA Convergence in Your Enterprise is a good source of information for start-up companies, or even those that are already using it. As it stands today, there are three main layers of Cloud computing. They are as follows: Software as a Service (SaaS), Platform as a Service (PaaS), and Infrastructure as a Service (IaaS) (1). In addition to those three main layers, there are many sub-services that take advantage of the Cloud, like e-mail carriers, QR code producers, and many more.

Software as a Service (SaaS) is often described as “software-on-demand.” Almost all of the heavy lifting and coding is done over the Cloud, which practically eliminates the need for a small business to have a dedicated server for the services used. The only thing that a business would need is a computer, which would have the client needed to connect to the Cloud for the software. Often times, this is an internet browser that would connect to the Cloud and give the business access to the software they need. From there, the service is rendered to the client computer, which can include accounting, collaboration, Enterprise Resource Planning (ERP), and Human Resource Management (HRM). Small businesses do not have to spend a large amount of money in order to get the permit to use the Clouds services, and can get a large ROI just from the initial sum. For a business to get the license, they must either pay an annual fee, or a monthly subscription. Once that is done, they have access to the server and the client, which as

stated can be a web browser. If it's not a browser, then it is a downloadable executable or application, which can be run on almost any computer. In this scenario, the computer must have the proper specifications to run the client, but they are usually provided before any fee is paid. After the fees have been paid, and the client downloaded, the business has access to the Cloud services to run the programs they require. If a company doesn't want to pay for the services, they can do what is called "freemium," which allows the company to use the client, but with a lowered capacity and usefulness. To lift this, small micro transactions can be paid for the segments that are needed, or the purchase of what remains of the client in order to have full access.

Small businesses benefit off of SaaS, largely due in part to the companies that run the servers at their own location. Thanks to having only the client at their location, there is no need for a server room or a large space dedicated for computers. The owner or workers only need a single computer or two to access the entire client and the servers as a result. On top of saving space for other items, there also would be no need to pay any workers just for that job, because anybody could do it now. A specialist wouldn't be required, so they would also be saving money. Take for instance, accounting software like TurboTax. It's a SaaS, with customer support in the form of online help or a phone center. When acquiring the software, it can be purchased either in disc form, or as an online download. Across all platforms, however, it remains the same. It wouldn't be smart of the company to change how the client works just because the business owner has a computer that runs a different operating system. Thanks to the time it took them to create the client, it can be used across almost all platforms, like Windows Vista, Windows 7, and the Mac exclusive Operation System, Mac OS X. TurboTax acts just like an accountant, which means they can do their taxes, income statements, and much more with ease. While TurboTax is a complete software package, it has limitations which can be set on it by the makers. For instance, if you use the limited version or "freemium," some restrictions are put on it and what it can do. Online help is also limited, so figuring out what needs to be done would have to be done more on the user side.

Another example of a SaaS product that's in very high usage these days is DropBox. DropBox is an online Cloud database, which allows those who sign up to upload pictures, files, music, almost anything to an online folder. Once they are placed in the folder, they have to sync across other computers or users. For example, if you upload a file on one computer, but don't have it on another, but you do have DropBox, all you would need to do is login and the computer would automatically retrieve the file without you needing to hunt for it. Signing up employees is as simple as sending them an email that contains a link through their system. From this link they can get the small client installed if it's on another computer, or they can just sign up for the service and get access to the folder if it's on the same system. The reason you would want them to have their own account is because the client saves who updated the file last, so if something goes wrong along the way, you can see just who it was that changed things. No matter where in the world the business may be located, the program can be run as long as you have Internet access, or on a phone with 3G/4G wireless. Thanks to the advances in cell phone technology, smart phones have a free app for DropBox, which is used much the same way as the computer based version, although it will probably be for lower file sizes. If a user over the phone network

wants to upload a large file, they would be better off connecting to a free wireless point then starting the upload.

How this helps a small business can be viewed in several ways. Since the online storage is free up to a certain size limit, there would be little need for an owner to buy a large hard drive. Of course, buying a large hard drive isn't a bad thing. If one is willing to spend a bit more money, a much larger capacity can be bought. However, there are some exceptions to this. External hard drives can cost more money the higher the space limit and they do tend to take up larger amounts of physical space. There are smaller ones that are out on the market, ranging from 250 GB to 1 TB, that are very small and would satisfy a business's needs adequately. Should a business need more space, then they would have to consider upgrading their infrastructure of their computers. DropBox prevents the need for the hard-drives, although there still is the problem of the sync time. If the file is accessed from another computer, it first has to be downloaded, and if it's a large file, then the time increases. An actual physical hard drive would prevent this, but would take up space. Flash drives are a good alternative, but if something large needs to be transported, it won't suffice.

The next category of Cloud computing that is commonly used is PaaS, Platform as a Service. Defined by Wikipedia as a category of Cloud computing services that provide a computing platform and a solution stack as a service (2), PaaS is between the SaaS and IaaS layers. PaaS offerings facilitate the deployment of applications without the cost and complexity of buying and managing the underlying hardware and software and provisioning hosting capabilities, providing all of the facilities required to support the complete life cycle of building and delivering web applications and services entirely available from the Internet. Because everything is done remotely, none of the actual hard computing is done on the client computer but is done instead on the host server. What this does mean, though, is that while the computing is done over the Cloud, the host server actually stores the information instead of letting the Cloud handle it. Right now, there are four different types of PaaS: add-on development facilities, which are add-ons to existing SaaS's, stand alone development environments, which provide a general development environment, application delivery-only environments, which only act as a hosting platform, and open platform as a service, which lets the client, or developer in this case, use any programming language, database, system, and more.

A good example that is well known for PaaS systems is ORACLE RDMBS, or Oracle as it's more commonly known. RDMBS stands for object-relational database management system, and is produced and marketed by Oracle Corporation. Created in 1977, Oracle was the first of its kind database that could store data logically in the form of table spaces, and physically in the form of data files (3). The newer editions can store data with specific headers instead of the default SYSTEM as it was back when first created. Oracle is used in today's businesses to store large amounts of data that can be easily recalled when someone knows how to use it. When entering data into the system, indexing it is key to getting the data back out. With the new versions of it, the user interface has been made easier and the tutorials that come included can help ease people into use. Data input into Oracle can range from sales figures and names, all the way to longer chains of information, like location of purchase and when they were made. Oracle creates reports based on what information you want to pull out of the tables that are created when you input data. Reports are very useful because information from multiple tables of data can be

created quickly. Sales figures can be in one table, while the client list can be in another, and date of purchase last. When coded correctly with a key term linking each table together, any type of report can be made.

Small businesses today use Oracle in many daily activities, not just database activities. When used by itself, it can serve as a RFS, remote file-server process, which is a partition alongside the rest of the files on the computer, which is only used to back up the current active data. RFS is a background service that runs when Oracle is started (4). This allows for data to be insured should the computer shutdown prematurely, or a power outage hit. Thanks to this feature, many companies use it for storing the large amounts of data that is hidden from the rest of the computer. This acts as a protection from some viruses that may hit if the user is active on the internet or hooking up external USB drives or hard drives. This is all part of the Data Guard service. If they purchased the upgraded Enterprise Version, they would have access to it from the start, instead of buying modules as they go. Data Guard has more than just those features, though, since it has another very important feature. SNP, or snapshot, takes constant “states” of what the computer is doing, or what you have open and preserves them in a folder for quick access should something go wrong. These “states” are like a picture of the database, and are cleared out occasionally so that they don’t take up a lot of hard drive space, or run into conflicting errors. Oracle can perform this itself, or it can be made to run and clear up space ahead of scheduled time. This does, however, run the risk of clearing the most recent ones, so there is some danger involved of doing it yourself.

In addition to Oracle, there is another well used PaaS that fits the definition perfectly, which is Google App Engine. Most people nowadays have a Gmail account, which can be used to sign up for the service. After doing so, users are granted access to easy-to-learn tools for creating applications on Google’s infrastructure (5). Once they have the people onboard the project that are the technical knowledge, programming can begin. The apps that are created through this engine can be quickly and easily changed, no matter where your workers might be; because, like DropBox, it syncs the changes made by one user for all the rest to see and alter as they need. GAE, as it will be referred to from now on, allows those apps to be distributed quickly, and efficiently through links from emails, direct downloads, or even better, through the Android Marketplace. This ensures that people will see it from using their phones because whether or not the application is a paid app or free, it still shows up in the new tab for either category. If it becomes popular, then more and more people will see it and likely download it. This can bring more business opportunities to the company and more income. However, this does leave out the chance to reach people with an iPhone, but that is to be expected, since Android is owned by Google and iOS by Apple. In addition to the distribution, the small business doesn’t have to worry about scalability or security while using it, because Google handles that on their end. This allows the business to focus entirely on what they want to do, and what clients may want, and if they should price it or let it be free and draw customers in for income.

Many small and large businesses have taken advantage of GAE to build apps for use on the internet and Android series phones. Best Buy, a provider of consumer electronics, used GAE to create an application called “Giftag” that is an add-on to the Firefox and Internet Explorer browsers (6). It allows people to add items that they see on any website to their own gift

registry, and notify others through social media of what they want. This is especially handy because it doesn't have to be only of items on the Best Buy site, so prices can change, item selection is more varied, and people don't have to look into getting you the item you want only at one site. Creating small snapshots of the item and site, you can organize a wish list and sort it in whatever way you want, like from high price to low, or most desired to less. Another company that took advantage of GAE, and one that's a small business to boot, is CloudLock. The founders of the company noticed that there was a lack of Cloud data protection and enterprise level control for apps created for the Cloud. So, they created applications and protocols that would better secure data transmission over the Cloud for people that download frequently (7). Created using GAE, CloudLock creates control for the users so they do not have to worry about security on their side or in the Cloud itself. Everything is handled by CloudLock, so people can continue to use Google Docs and other services offered by Google without fear of data loss or information stolen.

The last category for Cloud computing is IaaS, or Infrastructure as a Service. Defined as a provision model in which an organization outsources the equipment used to support operations, including storage, hardware, servers and networking components, it's used commonly by companies looking to keep interactions with customers only when they want it (8). A good example of it is desktop virtualization. There are programs that can be used in order to simulate another computer with specified settings or programs on the one you're currently using. With this, companies can save a lot of money before buying another computer or software by testing it in a virtual setting (9). It's also the most basic of the three categories of Cloud computing, in that almost everything is supplied by the host's data centers. Once everything is installed on the client's computer, they are in charge of maintaining it while being billed by the provider. This may seem odd, considering the previous two types of Cloud computing, but it works for the clients, considering that most of the setup is done via a template.

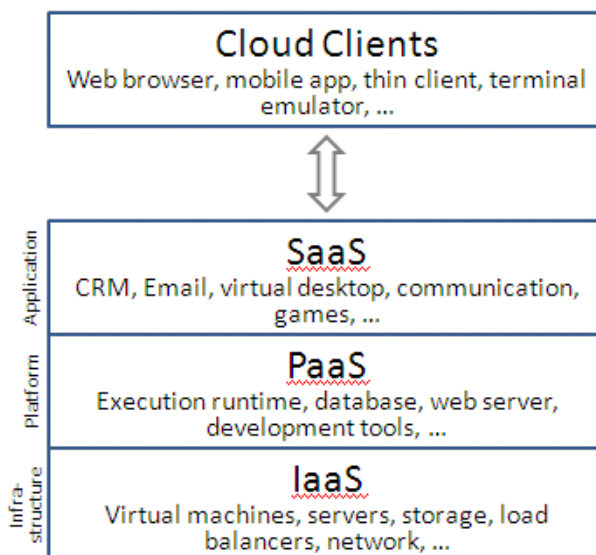
A very well known IaaS being used in the current times is Microsoft Azure Services Platform. Debuting back in 2010, it serves as a platform for Windows Azure, a Cloud operating system that serves as a runtime for the applications and provides a set of services that allows development, management, and hosting of applications off-premises (10). Windows Azure can be purchased in 41 countries, and has a free three month trial if you are unsure about its capability to help your company. Most of its usage is because it works well with Microsoft Visual Studio. However, while it is available commercially, it is not recommended for most small businesses because of its usage in more large scale operations. It is, however, still a good example of an IaaS that can be used.

Just as there are positives to using Cloud computing, there are also downsides to everything involved. SaaS's that specialize in data storage have taken a very large hit lately thanks to the recent closure of a website that served as a file storage and exchange hub. Mega Upload, which was created in March 2005, was a file hosting site that became notorious for its vast collection of both legal and illegal files, such as full length movies. Because of this, the FBI took action, and closed the site on January 19 of this year, citing multiple infractions against copyright. The files in question, and there were a significant number of them, were illegal uploads of movies, audio files, entire novels that were scanned into PDF format, and much more. Thanks to the abrupt shutdown of MU, several other file sharing sites quickly withdrew the

ability to share files, allowing only the person who uploaded them to retrieve them off of the site. This drew a lot of heated fire from people who used the sites for legitimate means, such as storing video from a birthday celebration, audio from an old recording device, or large segments of data used in presentations. Nonetheless, because of this, there has been concern about the future of Cloud storage. As of writing this, there are only two file hosting sites that have remained unaffected by the MU uproar: DepositFiles, and MediaFire. If files are uploaded, as long as they pass a small sniffing test set by the site, they can be retrieved by other people just by sending them a link to the file.

There is another glaring weakness to using services based over the Cloud. The user must be able to maintain an internet connection in order to have access to the service being rendered (11). In areas that may lose connection often, or have a lower connection speed, this can be very detrimental to the owners' satisfaction. Before signing up for any Cloud computing service, the client should look into how stable their internet is, and what, if any, limits exist on how much data can be transferred during a time period. There are some internet service providers (ISP) that will throttle the amount of data that can be delivered to the computer if the limit has been reached. Because they can do this without warning, you may find yourself in the middle of something very important, then suddenly facing significantly lowered internet speeds. Also, when signing up for the services, make sure to read the fine print to see what times they may be down for maintenance, if they don't send out a message beforehand. Some services, like the file hosting sites mentioned above, can go down for periods of time with or without warning, which would leave you without access to the files you need. If you share an IP address with multiple people in a small area, you need to be aware of what possible programs they might be running that could slow down your own connection speed. For example, if a user is using a torrent program, it tends to consume large amounts of bandwidth, which in turn lowers the speed at which other people on the connection can browse the internet or use any service related to it. Sometimes, if they are doing enough to consume a very large amount, the other users on the connection won't even be able to connect. This can be prevented, though, by making sure that when people connect to the network that is being used for other Cloud resources, that they can't use those programs, by shutting down the ports needed to access them on the connection itself. Blocking ports like this might hamper some of your own programs, creating havoc, so only do this as a last resort.

All in all, because of Cloud computing and the advances there have been in technology, it would not be farfetched to say that we exist in the Clouds. With all that is done today on computers and with smart phones, businesses can easily thrive or falter depending on how well they take advantage of what is offered. Simple things, like taking the time to look at an ad that was on an application on a smart phone, or going so far as to download an application made by your small business can bring many customers. It takes time, effort, and in some cases, money, but small businesses can use the Cloud to further their own profits and consumer base. Depending on what services are used, and how often, the market can be followed easily, trends taken advantage of, inventory updated, and much more. There really is no limit to what can be done right now with the Cloud, thanks to the people that continue to innovate and create new products for the world to see. If you would like more detail about companies that do Cloud computing, and do it well, please refer to the website provided as reference number 12 and 13.



## REFERENCES

- Linthicum, David C. "Cloud Computing Impact On Small Business." *Upload & Share PowerPoint Presentations and Documents*. Bick Group, 12 Apr. 2010. Web. 03 Feb. 2012. <<http://www.slideshare.net/Linthicum/cloud-computing-impact-on-small-business>>.
- "Software as a Service." *Wikipedia*. Wikimedia Foundation, 04 Jan. 2012. Web. 03 Apr. 2012. <[http://en.wikipedia.org/wiki/Software\\_as\\_a\\_service](http://en.wikipedia.org/wiki/Software_as_a_service)>.
- "Oracle Database." *Wikipedia*. Wikimedia Foundation, 04 Jan. 2012. Web. 03 Apr. 2012. <[http://en.wikipedia.org/wiki/Oracle\\_Database](http://en.wikipedia.org/wiki/Oracle_Database)>.
- Burleson, Donald K. "Oracle Background Processes." *Oracle Tuning: The Definitive Reference*. Kittrell: Rampant Techpress, 2011. 25-48. Print
- "Cloud Services." *Google App Engine*. Google Corporation. Web. 03 Apr. 2012. <http://www.google.com/enterprise/cloud/appengine/>
- Surya, Amanda. "Google App Engine Blog." Web log post. *Best Buy's Giftag on App Engine*. Google Corporation, 2 Feb. 2009. Web. 03 Apr. 2012. <<http://googleappengine.blogspot.com/2009/02/best-buys-giftag-on-app-engine.html>>.
- Zimmermann, Gil, and Ron Zalkind. "CloudLock." *The Cloud Data Security Company*. Cloud Lock. Web. 03 Apr. 2012. <<http://www.cloudlock.com/about/about-story/>>.
- "Infrastructure as a Service (IaaS)." *Infrastructure as a Service (IaaS)*. TechTarget, June 2009. Web. 03 Apr. 2012. <<http://searchcloudcomputing.techtarget.com/definition/Infrastructure-as-a-Service-IaaS>>.
- "Desktop Virtualization." *Wikipedia*. Wikimedia Foundation, 04 Jan. 2012. Web. 03 Apr. 2012. <[http://en.wikipedia.org/wiki/Desktop\\_virtualization](http://en.wikipedia.org/wiki/Desktop_virtualization)>.
- "Windows Azure." *Windows Azure*. Microsoft Corporation. Web. 03 Apr. 2012. <<http://www.windowsazure.com/en-us/support/faq/>>.

Martin, James A. "Should You Move Your Small Business to the Cloud?" *Reviews and News on Tech Products, Software and Downloads*. PCWorld, 29 Jan. 2010. Web. 03 Apr. 2012. <[http://www.pcworld.com/businesscenter/article/188173/should\\_you\\_move\\_your\\_small\\_business\\_to\\_the\\_cloud.html](http://www.pcworld.com/businesscenter/article/188173/should_you_move_your_small_business_to_the_cloud.html)>.

Reference Site: <http://raydepena.wordpress.com/2011/01/01/90-cloud-computing-companies-to-watch-in-2011/>

Reference Site: <http://nanospeck.hubpages.com/hub/Best-Cloud-Service-Providers>



# **CROWDFUNDING: A NEW OPPORTUNITY FOR SMALL BUSINESS AND ENTREPRENEURSHIP**

**Don B. Bradley III, University of Central Arkansas**  
**Charles Luong, University of Central Arkansas**

## **ABSTRACT**

*Over the past few years, the area of entrepreneurship has grown significantly and with this growth, there has developed a new realm of funding: crowdfunding. Crowdfunding allows individuals to source their funding from a various amount of individuals from platforms that can be found from the internet. This type of funding can be traced back to the early 1700's and is continuing to evolve ever since its inception as microfinancing. As crowdfunding continues to evolve, it only becomes larger and more successful with projects raising millions of dollars and products being shipped worldwide. This type of financing is not only reserved for business projects, some platforms allow people to fund charities and allow these crowd funders to give back to society. This paper explores the process of crowdfunding and some of its pitfalls.*

## **INTRODUCTION**

Combining the opportunity for entrepreneurs to make projects a reality, investors to turn someone's dream into a reality, or an average person donating to help better society, crowdfunding is not without its flaws. Crowdfunding is not a financing platform that is regulated; individuals have free reign to find funding through these online platforms for whatever they need funds for, to an extent. This situation puts banks in a predicament, since people are trying to fund their projects with hassle free rules; therefore, they are not seeking as many loans from the banks. Rules and regulations to alleviate potential perils are in the process of being put into place through an act signed into legislation as of 2012. In the coming pages, the paper will cover the history of crowdfunding and how it has become what it is today; the basics of crowdfunding and how it works; the larger platforms available to entrepreneurs wanting to have their projects crowdfunded; successful projects that have derived from crowdfunding; the implications of crowdfunding; rules and regulations and the future of crowdfunding.

## **THE ENTREPRENEUR**

Over the past decades the growth of the entrepreneur has become very prominent within the business world. Small businesses owned by the average person are turning into the norm just like any franchised company or large corporation. The days of working a typical schedule of "9-

5” are long gone. These entrepreneurs have pushed the corporate rules to the way side and became their own bosses. According to the text of *Small Business Management: Launching and Growing Entrepreneurial Venture*, an entrepreneur is defined as: a person who is relentlessly focused on an opportunity, in either a new or existing business, to create value while assuming both risk and reward for his or her effort (Longenecker, Petty, Palich & Hoy, 2012). Becoming an entrepreneur is as simple or as complex as you and the environment you are in allows it to be. The critical determinant is on what business opportunity that the entrepreneur decides to latch. As stated earlier, this can be a new or existing business to the entrepreneur’s environment. Funding this business venture may be the most difficult stage in the process. Many investors are leery to fund a person or business about which they know little. Luckily for entrepreneurs, within the past two decades crowdfunding has found its way to the internet.

## **CROWDFUNDING 101**

Crowdfunding is a newest evolutionary form of micro financing. The goal of crowdfunding is to help individuals get a financial start on the small business venture. Tanya Prive of Forbes defines crowdfunding as, “the practice of funding a project or venture by raising many small amounts of money from a large number of people, typically via the Internet” (Prive, 2012).

### **Historical Crowdfunding.**

The roots of this micro financing can be traced back to the 1700s when it was once called an Irish Loan Fund. Founded by Jonathan Swift, these loans were given to low income families in rural areas. These loans gained in popularity and peaked in the 1800s where over 20% of all Irish households held an Irish Loan Fund. The idea of micro financing did not stop in Ireland. The popular idea found its way to Bangladesh, India in 1976 where Dr. Mohammed Yunus provided banking opportunities to low income families on the same concept of the Irish Loan. Within five years of its inception, Dr. Yunus’ banking program grew to over 30,000 members from the original 42 females. In 1983, the original idea made a transformation from the small program into what is known today as Grameen Bank. According to Forbes, “Today (Grameen Bank) has more than 8 million borrowers, with 97% going to female operated businesses” (Farrell, 2012).

### **Modern Day Crowdfunding.**

Though micro financing was noted as early as the 1700s, it was not until just a few decades ago that some historical points shaped crowdfunding into what it is today. The first account of crowdfunding can be credited to Marillion, a British rock band, in 1997. Marillion

raised \$60,000 online through donations from their fans to go on a reunion tour ("The history of,"). After seeing the success of Marillion and the opportunity that could be seized from this type of financing, Brian Camelio started ArtistShare in 2000. ArtistShare is the first crowdfunding platform that allows fans of artists to fund the creation of new works from the artists ("About,"). Since emergence of ArtistShare, many other platforms of crowdfunding slowly made their appearance online.

In 2009, nine years after the appearance of the first crowdfunding platform, things began to pick up for the crowdfunding community. Popularity grew for entrepreneurs, investors became more interested, and the business world saw dollar signs. Fundable, a crowdfunding platform, reported, "Crowdfunding revenue tripled from \$530 million in 2009 to \$1.5 billion in 2011 and is expected to continue rapid growth in the coming four years" ("The history of,"). To be more specific, the growth rate is 74% compounded annually ("The history of,").

This progression and success has caught the attention of many but none larger than the United States government. Gaining support from the government has opened new doors of opportunity for entrepreneurs and small businesses to be financially supported. In April 2012 President Barack Obama signed the Jumpstart Our Business Startups (JOBS), "the crowdfunding bill", into law ("The history of,"). The bill attempts to reduce the regulations on small businesses and legalized equity funding. More details will be discussed on the bill later in the text. The nod of approval from the government sets fire to platforms and springs many entrepreneurs into action.

## **POPULAR CROWDFUNDING PLATFORMS**

### **Indiegogo**

Started in 2008, Indiegogo is an international crowdfunding site that has helped fund people in areas of music, film, small business ventures, and charities. Indiegogo is the "jack of all trades" as far as crowdfunding platforms is concerned. The site is geared towards keeping things simple allowing anyone with an idea or passion to join. It is as easy as signing up, starting a campaign, and raising money. How successful each campaign becomes is determined by each individual on how perks (shirts, product preorder, novelty items, exclusive product, etc.) for donating are structured, ability to relate to the campaign, and amount of publicizing the campaign receives. A campaign is deemed successful when the campaign reaches its funding goal by the set date. Depending on how a campaign is established in the beginning, users may have the choice to keep the raised money even if the campaign is unsuccessful, this referred as flexible funding ("Indiegogo - faq,"). On the other hand, if a user opts for fixed funding, all money raised must be returned to donors if the campaign does not reach its goal on time ("Indiegogo - faq,").

## **Kickstarter**

Often looked at as the rival of Indiegogo, Kickstarter got its start in 2009, one year after Indiegogo. Built on the same premise of helping people bring their ideas and dreams to life, Kickstarter has made its way to the top of the crowdfunding platform. Founders Perry Chen, Yancey Strickler, and Charles Adler did not succeed by duplicating a competitor, but rather going in a direction and model.

Kickstarter funding premise is an “all-or-nothing” funding. If your campaign does not reach its full goal by the set date, the pledged donations cannot be collected and must be returned to the donors (“Kickstarter 101,”). This radical model pushes users to campaign harder and promote their passion to make sure they receive the funding necessary. If a campaign does succeed and becomes “overfunded”, the individual is allowed to keep all excess funding to be put towards the project (“Kickstarter 101,”).

Another way Kickstarter has set itself apart is by being selective of projects that are allowed to be funded. Unlike other platforms, Kickstarter first screens the submitted project before allowing the user to post and start raising funds. This makes sure that all projects have a clear goal and can be completed, building a revolutionary pair of sunglasses for example (“Project guidelines,”). Charitable donations and open ended projects are not allowed to be campaigned on the site. Kickstarter strictly adheres to these rules and will not permit projects that violate the conditions to go live. In the case of this platform, sometimes not playing nice can lead to good things.

In the world of business, numbers and hard facts play a major role in showing how well a business is doing and Kickstarter is not shy about boasting their success. Since its inception, Kickstarter has averaged a 43.54% successful funding rate with a total of 87,891 projects launched (“Kickstarter stats,” 2013). In just a little over three years, a total of \$499 million dollars has been raised, with only \$422 million of that being successful dollars (“Kickstarter stats,” 2013). These numbers alone show the reason to why Kickstarter is the top crowdfunding platform with no end in sight.

## **Fundable**

Created by entrepreneurs Will Schroter and Eric Corl with the entrepreneur in mind, Fundable is the newest platform for crowdfunding; debuting in 2012. Fundable brings in ideas from the early platform of Indiegogo and crowdfunding leader, Kickstarter, into a new avenue to raise money. Tying the two “veteran” platforms together can potentially be a game changer for the crowdfunding environment.

Fundable takes the perks system of Indiegogo, where investors are rewarded for making certain tier donations with different products from the user, a step further. Investors can now be compensated with equity in exchange for funding the product (“Fundable faq,”). This gives the

investors choices to which type of compensation they would like to receive, whether it be a “perk” or equity.

Drawing from Kickstarter, Fundable adapts the “all-or-nothing” funding to their model. If the project does not receive its full funding, the project is considered unsuccessful and all money must be returned to the investors. Through Fundable, all funding does not have to be strictly monetary pledges, any other types of pledging is accepted ("Fundable faq, "). This can range from donation of skill set to donation of material, whatever that can help the user get their project moving in a positive direction.

Though some attributes of Fundable’s model are similar, the changes to adaptation of the attributes give Funable a competitive advantage. The platform is still young and only time will tell where Fundable will be heading.

## **SUCCESSFUL CROWFUNDED PROJECTS**

On the various platforms, most projects are a hit or miss depending on how well they are campaigned. Some projects become overly funded while others have zero dollars pledged. Over the years many projects have received their funding and made a hit in society, here are a few of the successful crowdfunded projects.

### **Pebble**

From the same developers who brought the inPulse smart watch to the Blackberry, RIM, platform brings consumers of the Android and iPhone smartphone a watch to match. The Pebble is an e-paper watch that connects users via Bluetooth to their smartphones allowing them to control their music, receive important notifications, run various apps, and of course tell time. Pebble Technology, the development team of Pebble, first attempted the traditional funding route with investors with no success. In April 11, 2012 is when a request was sent in to Kickstarter to start a crowdfunding campaign. Pebble’s initial goal was set to raise \$100,000 in a little over a month. Within the first two hours of the campaign launching Pebble Technology met its initial goal. 28 hours after the launch, Pebble breached the \$1,000,000 mark without any problem ("Pebble: E-paper watch, 2012"). By the end of the funding period on May 18, 2012, Pebble became the highest funded project on Kickstarter by raising an impressive \$10,266,845 with 68,929 backers ("Pebble: E-paper watch, 2012"). Pebble watches are now in full production and are shipping to countries around the world as on January 2013.

### **Double Fine Adventures**

With the goal of \$400,000 in the span of two months, Double Fine and 2 Player Productions easily surpassed the funding needed through Kickstarter. Double Fine and 2 Player

Productions raised a total of \$3,335,371 with 87,142 backers for their first point and click video game ("Double fine adventure," 2012). This amount raised makes Double Fine Adventures the top crowdfunded videogame. Double Fine and 2 Player Productions decided to do something different with their campaign and end goal, in addition to giving the backers perks for investing. Each investor will be able to view a walk through each part of the making of the game via a documentary. Tim Schaefer (2012), founder of Double Fine productions, stated,

“There will be a private online community set up for the backers to discuss the project with the devs and submit their thoughts and feelings about the game's content and direction, sometimes even voting on decisions when the dev team can't decide. Backers will also have access to help test the game once a beta is available. Once the game is finished, backers will receive the completed version in the available format of their choice.”

This direction gives backers the chance to help sway the direction they want their investment to go, just like how stockholders would do to the company they have stake in. The game is still in production and testing and is set to debut sometime in 2013.

### **1: Face Watch**

1: Face Watch is a Mirza Minds Indiegogo funded project that delivers a watch that not only looks good but also does well. The project was able to over fund its goal of \$25,000 with the donation of \$357,218 from 6,176 funders. Indiegogo's watch project is not just another watch; each watch purchased gives back to charities and organizations that need support such as the American Cancer Society. Mirza Minds offers the watch in six different colors; each color has a corresponding cause. Yellow represents water, black represents cancer, blue represents environment, red represents aids, pink represents breast cancer, and white represents poverty. According to the 1: Face Watch website, “Each watch comes with a metric which is carried out with the purchase of the watch” ("Faq,"). An example given by the video on Indiegogo campaign site was that a single watch purchase could feed up to 16 hungry children. Mirza Mind's mission with their watch shows that crowdfunding does not have to be all about fund a person's opportunity to create the latest and greatest, with the help of Indiegogo it can be to do something better for the world.

## **IMPLICATIONS**

Crowdfunding may look like the best option out there to raise money or be able to fund the next hit, but there are a few implications that must be looked at before deciding to crowdfund. Potential problems affect entrepreneurs seeking to raise funds, as well as investors

who are looking to help these entrepreneurs get their feet off the ground. First we will take a look at the problems that can plague entrepreneurs, then investor problems soon after.

As many people know, finding money to fund projects is not the easiest thing to do let alone asking for a group of strangers to donate to an idea just introduced to them. This can cause these potential donors to be a bit tedious giving money away since there is nothing physical in front of them to be able to look at. The internet has many other options for people to invest, why should someone want to fund a project through a crowdfunding website over investing it into the stock market? This option in front of the investors leaves the entrepreneurs in limbo. Without any rules or regulations thus far to help legitimize entrepreneurs, it will be hard for investors to be persuaded to donate money to a person for their legitimate cause.

The implications that entrepreneurs face are in direct correlation to the same problems that face investors. One of the main concerns for investors is the chances of fraud. Though there has yet to be any “facts” to prove that there has been a case of fraud through crowdfunding, according to Candace Klein, CEO of SoMoLend, there is still a lingering thought of it happening in investors’ minds. Another problem that has been seen with investors is stake in the project that is being funded. Since these investors are seeing a project through from its inception, many are looking for some sort of return or say into the project/company. As of 2013 there are few platforms and even fewer companies/projects allowing their funders to have any equity. An example of a good company that has done well in returning to their investors is Double Fine Adventures discussed earlier within the text. In order to deal with all of these implications from both end of entrepreneurs and investors, there must be rules and regulations to guide along crowdfunding; which has none of the two currently.

## **RULES & REGULATIONS**

### **JOBS Act 2012**

Mentioned earlier in the text, the Jumpstart Our Business Startups Act of 2012 was signed into legislation by President Barack Obama in order to encourage equity funding. One of the many goals of this act was to push many small unfunded private businesses to find funding through these funding platforms in exchange for equity in the business. Basically the act is pushing these businesses to grow by means of a small IPO. This gives a chance for the average individual to become an investor in something that they deem worthy to themselves.

Currently, as we have discovered in examples previously discussed in the text, crowdfunding platforms allow entrepreneurs to reward investors with “gifts” for their “donation”. Though this may not be true for all of the platforms on the web, since some do allow for equity in return, the JOBS Act will make this type of return available to all potential funders. My Say (2013) of Forbes makes the comparison as, “It is similar to Kickstarter’s donation system but where you receive stock instead of rewards for cash.” Again if a person who decides

to opt out of a reward and opt in to an equity return, it allows for the person to become an investor who may not have had the chance to do so otherwise.

Though equity funding may be the key idea behind the JOBS act, there are a few other pertinent key provisions. These provisions will attempt to regulate the amount that a family can “donate” to these entrepreneurs and how much entrepreneurs can raise through crowdfunding. According to the info graphic in Farrell’s (2012) article, *The JOBS Act: What Startups and Small Businesses Need to Know*, these significant provisions are,

- “1. A company can raise as much as \$1 million dollars a year from individual investors.
2. An investor whose net worth or annual income is less than \$100,000 can invest a max of \$2,000 or 5% of their income (whichever is greater).
3. An investor whose net worth or annual income is more than \$100,000 can invest a max of can give 10% of their income.”

These provisions are set in place to help protect investors from over investing that can potentially place them in financial hardships. The provisions also keep entrepreneurs from over funding, leaving potential investors for other projects that need to be funded.

The JOBS Act brings many positive options to the table of investing and crowdfunding, all of which can be beneficial to entrepreneurs and investors if handled correctly. To be handled correctly there needs to be correct regulation of the funding that is happening within these platforms. In order to have correct regulations, there must be the correct rules in place for these platforms to follow.

### **SEC Rules**

April 2013 marks the one year anniversary of the JOBS Act, but the year leading up to this anniversary has not been fruitful. The Securities and Exchange Commission (SEC) have yet to draft rules to govern crowdfunding through the JOBS Act. The SEC has been brought in to write these rules because of the stocks that can now be sold online through these online crowdfunding platforms. According to Say (2013), “Equity is the only issue in the JOBS Act where the SEC oversees any transactions of stocks in companies being offered.” In order to keep the legality and fairness throughout all stock exchanges via online or through the stock market, rules will need to be applied to all.

There are two specific areas that the SEC must draft rules for, Title III and Title IV. Title III deals with the area of general crowdfunding that is currently what we see now, while Title IV deals with the areas of traditional sophisticated investors. These drafted rules must take a look from both sides of the table: traditional free crowdfunding and regulated crowdfunding. If the



SEC favors one side more than the other, it can potentially ruin what is crowdfunding or the purpose of the JOBS act.

### **THE FUTURE OF CROWDFUNDING**

What is to come of crowdfunding in the future will be decided by what types of regulations are placed on the platforms. Too much regulation will bring the traditional aspects of crowdfunding down to traditional financing without allowing for the creativity ventures of entrepreneurs to be funded. Too little regulation will make the JOBS act irrelevant and not allow for investors to have a chance at equity funding.

Over regulation in any area tends to have a suffocating effect. In the case of crowdfunding, over regulation can suffocate the creativity of entrepreneurs. Danae Ringelmann (2013), co-founder of Indiegogo, states, “Too much regulation could stifle innovation and competition, and actually block the very economic activity equity crowdfunding is poised to create.” Crowdfunding inspired entrepreneurs to be creative and put their ideas out to the public. This type of encouragement allows for ideas which may not have been funded before become successful. This creativity stems from freedom; freedom to do anything without rules. Over the years crowdfunding has been able to make a name for itself and become a successful industry without regulation. This does not mean that there is no need for regulation, but there may not be a need to be extremely regulated.

Little regulation, though, may be prosperous for creativity. It can lead to potential problems in which the JOBS act is trying to alleviate. According to Ringelmann (2013), “Too little regulation could lead to risky behavior.” This risky behavior could potentially cause people to get over confident in crowdfunding and have investors fall victim to fraud. The SEC must find a middle ground, an area of regulation which will not inhibit creativity and not condemn risky behavior.

Without the rules from the SEC to regulate crowdfunding as of now, the new way to finance will continue to grow. Projects will continue to be funded, investors will continue to donate, and entrepreneurs will continue to innovate. Ringelmann (2013) shows that there is growth despite the delays from the SEC rules, “In the last year since the JOBS Act passed, more than 15,000 entrepreneurial campaigns raised money on Indiegogo in the U.S. alone.” There is no end in sight for crowdfunding; with the progress of technology it will only become easier for funding. Kickstarter for example has developed a mobile app for entrepreneurs and funders alike to keep up-to-date with projects and the funding they are receiving. The future of crowdfunding is bright and prosperous; time will only tell what is to come after the rules are set. This article only discusses crowdfunding within the United States. In other nations, crowdfunding is a norm and has been successful for many years. Hopefully America will see the positive effects from crowdfunding, as other nations have.

## REFERENCES

- Farrell, J. (2012, September 21). *The jobs act: what startups and small businesses need to know*. Retrieved from <http://www.forbes.com/sites/work-in-progress/2012/09/21/the-jobs-act-what-startups-and-small-businesses-need-to-know-infographic/>
- Klein, C. (2013, February 13). []. What is the future of crowdfunding?., Retrieved from In the last year since the JOBS Act passed, more than 15,000 entrepreneurial campaigns raised money on Indiegogo in the U.S. alone.
- Longenecker, J., Petty, J. W., Palich, L., & Hoy, F. (2012). *Small business management: Launching & growing entrepreneurial ventures*. (16th ed., p. 6). Mason, OH: South-Western Cengage Learning.
- Prive, T. (2012, November 27). *What is crowdfunding and how does it benefit the economy?*. Retrieved from <http://www.forbes.com/sites/tanyaprive/2012/11/27/what-is-crowdfunding-and-how-does-it-benefit-the-economy/>
- Ringelmann, D. (2013, April 05). *Crowdfunding industry celebrates first anniversary of jobs act despite delays*. Retrieved from <http://techcrunch.com/2013/04/05/crowdfunding-industry-celebrates-first-anniversary-of-jobs-act-despite-delays/>
- Say, M. (2013, February 19). *Why equity crowdfunding won't happen this year*. Retrieved from <http://www.forbes.com/sites/groupthink/2013/02/19/why-equity-crowdfunding-wont-happen-this-year/>
- About*. (n.d.). Retrieved from <http://www.artistshare.com/v4/About>
- Double fine adventure*. (2012, February 08). Retrieved from <http://www.kickstarter.com/projects/doublefine/double-fine-adventure>
- FAQ*. (n.d.). Retrieved from <http://1facewatch.com/faq/>
- Fundable FAQ*. (n.d.). Retrieved from <http://www.fundable.com/FAQ>
- Indiegogo - FAQ*. (n.d.). Retrieved from <http://www.indiegogo.com/indiegogo-faq>
- Kickstarter 101*. (n.d.). Retrieved from [http://www.kickstarter.com/help/faq/kickstarter basics?ref=footer](http://www.kickstarter.com/help/faq/kickstarter-basics?ref=footer)
- Kickstarter stats*. (2013, February 26). Retrieved from <http://www.kickstarter.com/help/stats>
- Pebble: E-paper watch for iphone and android*. (2012, April 11). Retrieved from <http://www.kickstarter.com/projects/597507018/pebble-e-paper-watch-for-iphone-and-android>
- Project guidelines*. (n.d.). Retrieved from <http://www.kickstarter.com/help/guidelines>
- The history of crowdfunding*. (n.d.). Retrieved from <http://www.fundable.com/crowdfunding101/history-of-crowdfunding>

# **NEW MENU LABELING REQUIREMENTS FOR RETAIL FOOD CHAINS: POSSIBLE IMPACT ON SMALL BUSINESS RESTAURANTS**

**Dawn Langkamp Bolton, Western Kentucky University**

## **ABSTRACT**

*Recent legislation requiring retail food chains (with 20 or more locations) to post the calories of menu items prompted new research on the effectiveness of such labeling. Given the growing obesity epidemic in the United States, studies primarily focus on the individual consumer and that person's food choices, given caloric labeling. Little has been written about the impact of the legislation on the retail food chains' business, and even less has been considered for those restaurants that do not fall under the legislation. This manuscript considers the possible impact of the legislation on those small business restaurants and calls for research into this new area of business studies.*

## **INTRODUCTION**

According to the Centers for Disease Control, there has been a dramatic increase in obesity in the United States during the past 20 years; currently more than one-third of adults in the U.S. are obese (CDC, 2012). Additionally, it is estimated that nearly one-third of the calories consumed by Americans come from food prepared outside the home (Federal Register, 2011). In light of these trends, legislation under the Patient Protection and Affordable Care Act of 2010, requires retail food establishments with 20 or more locations (doing business under the same name and offering essentially the same food items), to provide calorie information for standard menu items (U.S. Food and Drug Administration, 2013). According to a preliminary regulatory impact analysis by the Office of Regulations Policy and Social Science, Center for Food Safety and Applied Nutrition, these menu labeling requirements “should help consumers to make more informed choices about the nutritional content of the food they purchase” and “should help consumers limit excess calorie intake and understand how the foods that they purchase at these establishments fit within their daily caloric and other nutritional needs” (2011, p. 3).

These mandated menu labeling requirements prompted new research on the effectiveness of such labeling. Recent studies focus on the individual consumer (e.g., food choices, given caloric labeling) or on the food itself (e.g., the change of menu items given the new legislation). However, little has been written about the impact of the legislation on the retail food chains’

business, and even less has been considered for those small business restaurants (i.e., food establishments with less than 20 locations) that do not fall under the legislation.

Following a brief summary of a sampling of the two types of recent studies (i.e., focus on the individual and focus on the food), the impact of the legislation on both food chain restaurants and small business restaurants is considered. Finally, research ideas on the impact of businesses not falling under the guidelines of the menu labeling legislation are offered.

## **RECENT RESEARCH ON THE EFFECTS OF MENU LABELING LEGISLATION**

Since the legislation requiring retail food chains (of 20 or more locations) to post calorie information for standard menu items, research has focused on the individual's food choices or on the food offered by the retail chain establishments. Results have been mixed on whether or not menu labeling influences the individual's purchase decision (Vadiveloo, Dixon, & Elbel, 2011; Dumanovsky, Huang, Nonas, Matte, Bassett, Silver, 2011). A recent dissertation found that providing calorie information did not influence participants purchasing behavior (Higgins, 2012), while Ellison, Lusk, and Davis found that "calorie labels in restaurants can be effective, but only among those restaurant patrons who have lower levels of health consciousness" (2013, p. 8).

Qualitative research, in the form of focus groups, was used by Schindler, Kiszko, Abrams, Islam, and Elbel in determining that while most of the subjects were aware of menu labeling, "the majority were not regularly using the calorie information to guide their food choices" (2013, p. 668). Schindler et al. (2013) further identified individual-level factors taking precedence over calorie counts when subjects made food choices including a lack of understanding of "the meaning of a calorie or the importance of calories on health outcomes" (2013, p. 669). This supports work by Headrick, Rowe, Kendall, Zitt, Bolton, and Langkamp-Henken (2013) who found "a lack of basic nutrition knowledge about personal energy needs in individuals across all BMI categories regardless of age, race/ethnicity, level of education, or work/training in a health-related field" (2013, p. 1). The authors further conclude that "Calorie labeling of foods may be effective in enabling consumers to make informed decisions on the selection of foods that fit within their daily energy requirements only if they know their daily requirements" (2013, p. 5), and that this basic knowledge appears to be lacking.

In addition to the research at the individual consumer-level, the impact of the food labeling legislation on the actual food being offered by the retail food chains is also being studied. For example, Bruemmer, Krieger, Saelens, and Chan (2012) compared the nutritional levels of menu items six months and 18 months after legislation and found modest improvements in calories, saturated fat, and sodium although levels were still excessive. And in Canada, where similar menu labeling legislation is being considered, Scourboutakos and L'Abbe' (2012) analyzed the calorie content of restaurant foods in an effort to better understand how factors determining calorie content may influence the effectiveness of the labeling.

From this brief summary of the research, it does appear that work remains to be done in order to truly gauge the impact of the food labeling legislation on both the consumer and on the food offerings of the retail chains affected by the mandate. Next, attention is turned to the impact of the legislation on both food chain restaurants and small business restaurants.

### **IMPACT ON FOOD CHAIN RESTAURANTS**

As part of its preliminary regulatory impact analysis of menu labeling, the FDA considered the costs to those food chain restaurants complying with the legislation and the benefits associated with the new requirements. The impact analysis report identified three direct elements of cost burden to those retail food chains impacted by the legislation:

1. Collecting and managing records of nutritional analysis for each standard menu item.
2. Revising or replacing existing menus, menu boards and other affected displays.
3. Training employees to understand nutrition information in order to help ensure compliance with the proposed requirements (FDA, 2011, p. 10).

The estimated cost of these three elements was an initial mean cost of \$315.1 million and an ongoing mean cost of \$44.2 million (FDA, 2012, p. 12). While the FDA did not attempt to predict the actual direct benefits of the legislation, using an estimate of “a 100 calorie per week reduction in intake as the benchmark effect” the FDA did estimate “that at least 0.06 percent of the adult obese population would need to reach at least this benchmark” (FDA, 2012, p. 12) in order to cover the mean annualized costs of the legislation through the reduction of “adverted medical expenditures” (FDA, 2012, p. 8) due to obesity. The FDA in its impact analysis did acknowledge that retail food chain prices may rise to reflect the new costs of the legislation which in turn may cause consumption to fall “further reducing profits for some, or all, of these establishments” (FDA, 2012, p. 10).

The benefits to the food chain restaurants stated in the impact analysis include “increased consumer interest in lower calorie options and greater transparency regarding calorie content of menu items, which may give firms an incentive to ...provide additional items with lower calorie formulations” (FDA, 2012, p. 9).

### **IMPACT ON SMALL BUSINESS RESTAURANTS**

While provisions are in the regulations for small business restaurants to voluntarily list the calories of menu items, costs of complying would be “spread out” over fewer locations (i.e., less than 20) thus more expensive on a per-restaurant basis, than for the retail food chains. In addition, the small business restaurant owner may not have access to a nutritionist/dietitian who could determine the calorie content of the menu items, as the larger retail food chains would. A quick search of the Internet for companies that did nutrition analysis showed one service that charges “as little as \$99 per recipe” (Roche Dietitians) which could become costly for a small

business restaurant over time. However, if small business restaurants choose not to voluntarily list calories, then there is no compliance cost (nutritional analysis, menu changes, and training of employees) incurred by these businesses, possibly giving them a slight edge on price over the retail food chains that must comply.

The potential benefits of not complying with the menu labeling legislation may include that consumers don't want to know what the calorie count of their food choice is. The old "ignorance is bliss" adage may come into play. Consumers visiting their favorite eatery with the intent to splurge on their desired foods may not want to know the calorie count of their choices! Also, while the retail food chains may be faced with cutting calories so as to retain customers, the small business restaurants won't have to change their recipes for fear of losing customers. Their menu items can remain as their customers remember them: filled with fat (and calories) and "still delicious."

### **CALL FOR FUTURE RESEARCH**

While research into the choices that individuals make in light of the new menu labeling legislation has begun, little has been written about the impact on the retail food chains' business, and even less has been considered for those restaurants that do not fall under the legislation. Potential benefits and costs to small business restaurants that do not voluntarily comply with the mandate should be assessed. Research into this new area of business studies should include looking at food choices individuals make in restaurants that fall under the guidelines versus in those restaurants that do not. Additionally, small business restaurant owners should consider research that determines if their customer base would prefer menu labeling or not.

Research on menu labeling in small business restaurants (those with less than 20 locations) is practically nonexistent. Given that retail food chains are now required to provide calorie information for standard menu items and that small business restaurants are not, an opportunity exists for research that not only compares the choices of the individual in both types of business, but compares the impact of the menu-labeling legislation on each type of business.

---

## REFERENCES

- American Heart Association (2013). Heart disease and stroke statistics—2013 update: a report from the American Heart Association. *Circulation* on behalf of the *American Heart Association Statistics Committee and Stroke Statistics Subcommittee*, 127(e6-e245).
- Bruemmer, B., J. Krieger, B.E. Saelens, & N. Chan (2012). Energy, saturated fat, and sodium were lower in entrées at chain restaurants at 18 months compared with 6 months following the implementation of mandatory menu labeling regulation in King County, Washington. *Journal of the Academy of Nutrition and Dietetics*, 112(8), 1169-1176.
- CDC Centers for Disease Control and Prevention (2012). Overweight and obesity facts. Retrieved July 9, 2013 from <http://www.cdc.gov/obesity/data/facts.html>
- Dumanovsky T., C.Y. Huang., C.A. Nonas., T.D. Matte., M.T. Bassett, & L.D. Silver (2011). Changes in energy content of lunchtime purchases from fast food restaurants after introduction of calorie labeling: cross sectional customer surveys. *BMJ: British Medical Journal*, 343:d4464.
- Ellison, B., J.L. Lusk & D. Davis (2013). Looking at the label and beyond: the effects of calorie labels, health consciousness, and demographics on calorie intake in restaurants. *International Journal of Behavioral Nutrition and Physical Activity*, 10(21).
- Federal Register. (2011). *The Daily Journal of the United States Government Unified Agenda*. Retrieved July 9, 2013 from <https://www.federalregister.gov/regulations/0910-AG57/food-labeling-nutrition-labeling-of-standard-menu-items-in-restaurants-and-similar-retail-food-estab>
- Headrick, L.B., C.C. Rowe, A.R. Kendall, M.A. Zitt, D.L. Bolton, & B. Langkamp-Henken (2013). Adults in all body mass index categories underestimate daily energy requirements. *Journal of Nutrition Education and Behavior*. Retrieved July 4, 2013 from <http://www.sciencedirect.com/science/article/pii/S1499404613000043>
- Higgins, J. A. (2012). An analysis of the influence of nutrition information on consumers' restaurant menu choices. *Theses and Dissertations--Dietetics and Human Nutrition*. Paper 3. Retrieved from [http://uknowledge.uky.edu/foodsci\\_etds/3](http://uknowledge.uky.edu/foodsci_etds/3)
- FDA, Office of Regulations Policy and Social Science Center for Food Safety and Applied Nutrition (2011). Food labeling: Nutrition labeling of standard menu items in restaurants and similar retail food establishments notice of proposed rulemaking. Docket No. FDA-2011-F-0172, *Preliminary Regulatory Impact Analysis*. Retrieved July 5, 2013 from <http://www.fda.gov/downloads/Food/IngredientsPackagingLabeling/UCM249276.pdf>
- Roche Dietitians, *Menu Labeling Solutions* retrieved July 10, 2013 from <http://www.rochemenu.com/who-we-serve>
- Schindler, J., K. Kiszko, C. Abrams, N. Islam, & B. Elbel (2013). Environmental and individual factors affecting menu labeling utilization: A qualitative research study. *Journal of the Academy of Nutrition and Dietetics*. 113(5), 667-672.
- Scourboutakos, M.J. & M.R. L'Abbe' (2012). Restaurant menus: Calories, caloric density, and serving size. *American Journal of Preventive Medicine*. 43(3), 249-255.
- U.S. Food and Drug Administration (2013). Menu & Vending Machines Labeling Requirements. Retrieved July 4, 2013, from <http://www.fda.gov/Food/IngredientsPackagingLabeling/LabelingNutrition/ucm217762.htm>
- Vadiveloo, M.K., L.B. Dixon, & B. Elbel (2011). Consumer purchasing patterns in response to calorie labeling legislation in New York City. *International Journal of Behavioral Nutrition and Physical Activity*, 8(51).





# **FAMILY BUSINESS SUCCESSION: WHAT ARE THE WAYS USED BY THE MEN BUSINESS MANAGERS TO LEGITIMIZE THEIR SUCCESSORS?**

**Vivi Koffi, University of Moncton**  
**G rard Fillion, University of Moncton**  
**Jean-Pierre Booto Ekionea, University of Moncton**  
**Tania Morris, University of Moncton**

## **ABSTRACT**

*This paper aims at helping entrepreneurs to make their family business succession successful. Among the success factors of the succession, the successor's legitimacy seems determinant. This exploratory study involving five cases of succession by men predecessors shows that the outgoing leader can increase the legitimacy of his successor by helping him to develop his skills, by giving him responsibilities and authority, and by helping him to show his ability to be successor and to be respected.*

## **INTRODUCTION**

For Aronoff and Ward (1994) as well as Bruce and Picard (2005), the family businesses represent a model for the future, not only because the values they convey and their commitment in their respective communities on the redundancy and cultural plan (Astrachan & Shanker, 2003; Deloitte & Touche, 1999), but also because they establish a driving strength of the economic growth. Indeed, only in Canada, they represent about 75% of all the companies, with approximately 45% of the Gross National Product (GNP), and they provide work for 50% of the workforce (Cadieux & Brouard, 2009; Family Firm Institute, 2003; Le Breton-Miller et al., 2004; Richer et al., 2004; Sharma, 2004).

However, most of these companies face a problem of transmission. According to the results of the study conducted by Bruce and Picard (2005), 41% of the business managers are going to transfer their company before the next five years and this proportion will reach 71% in the upcoming 10 years. But only 35% of the business managers have a plan to sell or transfer their family business. Bruce and Picard (2005) also argue that 10 years are needed approximately to prepare the succession in good conditions. In addition, according to the *Oeuvre Suisse d'Entraide Ouvri re* (OSEO) (2005), only 20% of the family companies succeed in the passage of the first to the second generation in the six years following the transfer by the manager.

The success of the transmission is depending on a variety of factors. It is associated, not only to the predecessor's decision to leave (Lansberg & Astrachan, 1994) or to let go (Bah, 2008; Brun de Pontet et al., 2007), but also to the succession planning (Sharma, 2004; St-Cyr & Richer, 2005), and to the successor's ability to take the lead (Venter et al., 2005). Other authors emphasize the predecessor's skill to establish good relations with his successor (Cabrera-Suárez, 2005; De Massis et al., 2008; García-Álvarez et al., 2002).

Other studies have been performed on the successor's skills to assume his leader's role (Mitchell et al., 2009; Venter et al., 2005), but also on his experience (Le Breton-Miller et al., 2004), commitment, satisfaction, and motivation (De Massis et al., 2008). For other authors, some dynamics should not be neglected, for example, the transmission of good values to the successor (Garcia-Alvarez et al., 2002), the successor's development (Cabrera-Suarez, 2005), the importance for the successor of feeling integrated throughout the process (Haberman et al., 2007; Koffi, 2008), and the predecessor's disengagement (Bah, 2008; Cadieux, 2007). Finally, a particular and growing importance is accorded to the acquisition of legitimacy which, according to numerous authors, is a success factor of the business transmission (Barach et al., 1988; Cullière, 2010; Koffi, 2008; Sathe, 1985).

The need to support the predecessors in a successful succession brings all its relevance to the main objective of this research. This objective is to grasp the predecessor's behavior to legitimize his successor. Several studies indicate that the men business managers adopt a different leadership from those of the women in a similar position (Bass, 1990; Eagly et al., 2003; Koffi, 2008). The diversity needed to face the complexity in the transmission of companies justifies the interest to analyze the succession behaviors according to the predecessor's gender. In this study, the specific objective is then to understand and to describe how the men family business managers near to retire bring their successors to gain their legitimacy in the company, while this legitimacy seems to be very important for the timelessness of the company (Barach et al., 1988; Sathe, 1985).

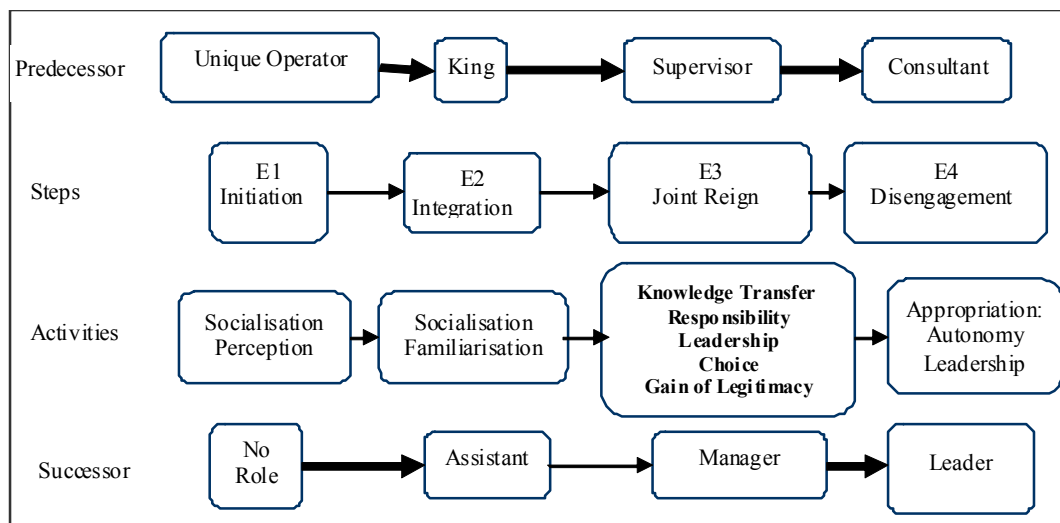
In other words, what would be the winning behavior to be adopted by the predecessors to support the acquisition of legitimacy by their successors? What would be the characteristics of a legitimate successor? In order to answer these questions, our approach consists to present, first, a framework of analysis explaining the stakes in the succession problem. This framework is based on the transmission of family businesses, on the concept of successor's legitimacy, and finally, on the notions of leadership behavior of the men business managers. Second, the qualitative methodology used to conduct the study and the results got are then described. And the paper ends with a discussion about the results.

## THEORETICAL CONTEXT

### The Succession Process in the Family Businesses

The succession process in the family businesses has two dimensions: ownership transfer and direction transfer (Hugron, 1992). The direction transfer is presented in four different phases in a process during which both the predecessor's and the successor's roles and functions evolve in an overlapping way (Handler, 1990). In the first phase, the initiation phase, the predecessor shows to his successor the functioning of the company while trying at the same time to raise his interest. This initiation phase continues until the successor's social integration phase, where he might perform part-time functions within the enterprise. In the third phase, the joint reign phase, the legitimate heir makes his entry in a more official way into the company. This legitimate heir is not only chosen according to his skills and to the interest demonstrated (Haddadj & D'Andria, 2001), but also according to the quality of his relation with the predecessor and all the other actors (Lansberg & Astrachan, 1994). During this joint reign phase the successor gets acquainted with the company, he is recognized by working closely with the employees and the predecessor (Hugron, 1992; Lajeunesse, 1989). It is at this stage that the gains of legitimacy, of which Barach et al. (1988) underline all the importance, are essential. The predecessor then plays precise roles with the successor (Cadieux, 2004). He is transferring to him the knowledge, the philosophy of life, the philosophy of management, the responsibilities, and the power (Hugron, 1992; Lajeunesse, 1989) until he completely retires in the disengagement phase, the last phase (see Figure 1).

**Figure 1**  
**The Succession and Legitimacy Process**



But, what is the process to follow when the predecessor, not only attached to his company but also in search of its timelessness, decides to retire and to leave the enterprise to his successor? The latter must manage employees who often saw him being born and growing, and besides, are acquired most of the time at the particular cause of the father. According to Barach et al. (1988) and Koffi and Lorrain (2005), a problem of legitimacy is then raising. This problem is examined in the next subsections.

### **The Successor's Legitimacy**

The transmission of companies raises some questions concerning the legitimacy of the rescuer because any management component of an enterprise is founding its power status on a legitimacy system. In the case of family companies, at our knowledge, the concept of legitimacy has not been studied from an empirical view. The family transmission is a process of redefining the bases of the power given the successor acquires an entity of which the identity is already established (Riot et al., 2007). In addition, the family company is widely influenced by different coalitions which pursue specific objectives and which have this capacity to condition the social acceptability of the leader's decisions (Deschamps & Paturel, 2001; Cullière, 2010). The successor's legitimacy is then handled in a perspective of social acceptance, interpreted as the right to manage, and granted to the successor by the predecessor and the employees given these ones consider, according to his charisma and the tradition, that the successor will satisfy their expectations.

In accordance with Petit and Mari (2009), we defined the leader's legitimacy as being:  
*“The recognition (formal/informal; explicit/implicit) by internal and external stakeholders of its right to govern the company: this recognition leans on the faith the aforementioned stakeholders in the validity of the power of the leader towards values and towards standards shared about the direction (the management) of company”* (p. 18).

In this way, it seems convenient to consider the foundations of the Weber's notion of legitimacy, since there is a combination here of the personal characteristics and the attribution of power. For Weber (1971), legitimacy is the central pillar of the domination. Being interested into the social activities which have a sense for the individual, Weber (1971) defines action as a behavior driving the meanings for the actor. According to him, the social action gets organized in social relationships: when several actors are in interaction, the sense of action of each relates to the attitude of the other one, such that the actions are mutually directed the ones towards the others. The social relationships containing oppositions, conflicts and compromises, and the need to dominate, play an important role in the legitimacy.

This brings to three legitimization systems. According to Weber (1971), the first one, of legal rational type, is linked to the function and not to the person. This legitimization system is based on the faith in the legality of the regulations and the right to give directives which is attributed to the leader. These normative rules define the way that we can promote a law or name a responsible person acting within the limits of his authority. The right is established by the pact (multilateral decision) or by the granting (unilateral decision) in a rational view (Cullière, 2008) of which the primary objective is to be followed by the community members. The one that obeys makes it in the respect of pre-established laws and rules.

The second legitimization system, of traditional type, is founded on the daily belief to the sacred character of the social order, such as it appears, and on the legitimacy of those who are called to exercise authority by these means. It is the observation of the custom and no more of the right which gives to the chosen individual the right to be obeyed by others. The relation between dominant and dominated is established on the respect and passed on with the help of a common education to the social group. The holder of the power can be represented as a lord identified by the tradition and of which the orders are accepted according to this tradition.

This tradition determines the extent which is socially accepted by the field of power. The third legitimization system, of the charismatic type, is based on the extraordinary submission to the sacred character and to the exemplary and heroic value of a person. This value is founded on the strength of character of the person, on its strength of conviction, and on its capacity to gather and mobilize individuals. These characteristics are considered by the dominated as supernatural. The recognition of the charisma by the ardent supporters of the dominant is made up by the phenomenon of confirmation, event which decides on the extraordinary character of the leader (Cullière, 2008; Weber, 1971). So the confirmation brings the managed to a feeling of hope, worship and confidence in the leader. However, we must think that the charismatic domination, specifically irrational, will tend to disappear if the visible power disappears, if the failure persists, and if the prosperity is not there.

For Weber (1971):

*“The experience shows that no domination is naturally willing to establish its timelessness on motives strictly material, or strictly affective, or strictly rational in value. On the contrary, all of the dominations are trying to awake and to keep the faith in their legitimacy.”* (p. 220)

So, according to the Weber’s view above, the legitimacy would be only a social faith, the one that confirms the power held by the dominants. Concerning the family transmissions, the nearness of the family link with the company is a very important element in the gain of the successor’s legitimacy. Some authors argue that this legitimacy is mostly either of traditional or of charismatic type (Cullière, 2008; Deschamps, 2000; Koffi & Lorrain, 2005). The successor appears the more often as a “legal successor” at the place of director, but who did not necessarily gain his position. The successor’s resistances (Koffi, 2008) can easily appear if the transmission

is not very well prepared, which can represent a brake to the successor's legitimacy and to his capacity to lead the company to the timelessness.

In order to get legitimacy, Barach et al. (1988) mention that both the predecessor and the successor must be convinced that the successor has the status and the skills of a leader. The successor has to feel that he is playing a very important role into the company and he must be perceived by the directors as having gained his status with the authority rather than having inherited the responsibilities and the authority by nepotism (Barach et al., 1988; Fiegenger et al., 1996). This legitimacy must be also demonstrated to the potential successor by actions and gestures of the other members of the company (Barach et al., 1988). For Fiegenger et al. (1996), the preparation of the successor to acquire the legitimacy requires much more than the relation between the predecessor and his successor or the acquisition of internal knowledge and skills.

The predecessors must favor, particularly at the external level, the interactions raising the visibility of their successors in public and giving them the opportunity to make the concrete differences. This would prove that the position got is legitimate, even if some authors find that a too explicit approach can be counterproductive (Jolicoeur, 1994; Lajeunesse, 1989; Ward, 1987). It is therefore essential for the successor to integrate the predecessor's and the employees' expectations to his actions. It is also necessary that the projects of the successor be accepted as legitimate by the staff at the risk of seeing dysfunctions and resignations on the part of the key staff arising (Deschamps & Paturel, 2001).

The members of the enterprise consider that the legitimacy of the rescuer leans, among others, on the phenomenon of auto-socialization, and that the recognition of the leader's abilities by the observers can be made only over time, according to the results obtained. By taking into account what is discussed previously, it is important to understand which leadership behaviors the men entrepreneurs adopt in the legitimization of their successors.

### **The Leadership Behavior of the Men Business Managers**

First, to understand the leadership behavior of the men business managers in the process of legitimization of the successors demands to take into account the theory of transactional and transformational leadership developed by Bass (1990), two independent and complementary approaches for the study of the leaders' behavior with their subordinates (Bass & Avolio, 1994).

The transactional leader brings to his subordinates what they wish, in other words the contingent rewards, in exchange of compulsory objectives. This type of leadership involves a more conventional management style, of clarification of the subordinate's responsibilities to reach the objectives, and of penalty, in the case where the objectives are not reached (Bass, 1990). Three behaviors of transactional leadership are noted: 1) the attribution of rewards according to the performance; 2) the management by active and passive exception; and 3) the non-interventionism characterized by a general casualness regarding the responsibilities.

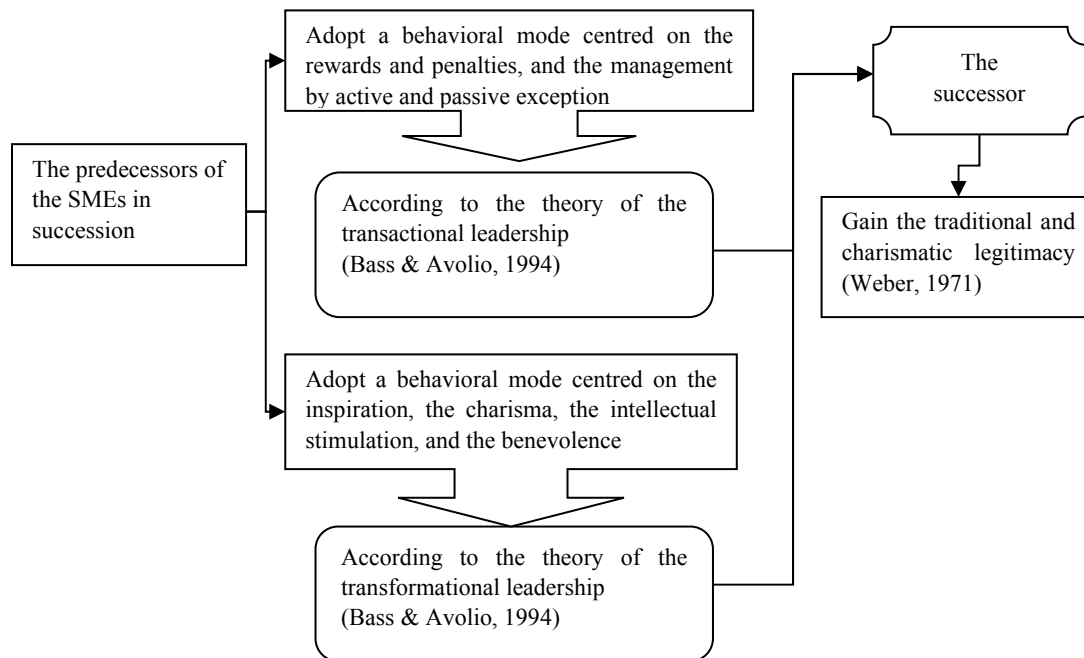
As for the transformational leaders, they are charismatic, persuasive, and capable to intellectually stimulate others. Each leader of this type is capable to "transform" the members of

his organization by making them more aware of the importance of their tasks and by helping them to spread their horizon beyond their personal interests to bring the mission of the company to a successful conclusion. Five characteristics refer to the transformational leadership: 1) the charisma with regard to the attributes; 2) the charisma concerning the behavior; 3) the inspiration; 4) the intellectual stimulation; and 5) the benevolence.

According to the researchers, the men are generally more likely to use the aspects of the transactional style, that is, the rewards and penalties, the management by active and passive exception, and the non-interventionism in management situations. And the aspects of the transformational style are more often used by the women administrators (Alimo-Metcalfe & Alban-Metcalfe, 2001; Avolio & Bass, 2002; Eagly et al., 2003; Koffi, 2008; Rosener, 1991).

In sum, the papers on the family companies do not clearly indicate the dimensions of the legitimacy and the behaviors adopted by the predecessors to favor the legitimization of the successor towards the staff of the company. Nevertheless, the conceptual studies on the legitimacy (Cullière, 2008; Deschamps, 2000; Koffi & Lorrain, 2005; Petit & Mari, 2009; Weber, 1971) and the studies on the theory of the transactional and transformational leadership allow us to present a conceptual framework (see Figure 2) with the following postulates.

**Figure 2**  
**The Relationship between the Predecessor's Behaviors and the**



On the one hand, the predecessors near to retire would adopt a behavioral mode more centred on the transactional leadership than the transformational leadership (Bass & Avolio, 1994, Eagly et al., 2003; Rosener, 1991) to bring their successors to gain the legitimacy. On the other hand, the context of family company succession would favor the legitimacy towards the members of the company seen under traditional and charismatic angles rather than rational legal.

## METHODOLOGY

### Sample

To understand the complex context of behavioral modes adopted by the predecessors to legitimize their successors towards the company members, we privileged a qualitative research. In fact, a strategy of exploratory case study and multi-sites (Hlady-Rispal, 2002) was retained given the phenomenon, taking part of a new problematic for which there are only few empirical studies (Grenier & Josserand, 1999), can exist only in the context in which it evolves (Yin, 1994). To study these complex cases, we opted for a procedure of theoretical sampling. In other words, five cases were chosen for theoretical (and not statistical) aspects (Hlady-Rispal, 2002).

We took into account the following sampling criteria: a process of succession of the first to the second generation in process and possibly finished; a succession mother-girl or son and father-girl or son; a company of the manufacturing or service sector from 10 to 250 employees; the retained employee having worked for the company with the owner manager before or while the successor made his entry into the company. The difficulty to obtain referees satisfying all the chosen criteria brought us to opt for a sampling by reasoned choice, that is, we chose deliberately the subjects, as they were found capable of authorizing the understanding and the interpretation of the behaviors of the successor's legitimization.

Considering the retained criteria, five companies (three predecessors in Quebec and two predecessors in New Brunswick), in the process of the first generational transfer and in which at least a member of the family holds the control of the property and the management (Cadieux & Brouard, 2009), were retained (see Table 1). Three predecessors have already transferred the company to their successors. The two others having expressed their firm intention to transfer the company are at a late stage of the process.

Table 1 presents the number of interviews performed, the profiles of the retained small and medium enterprises (SMEs) in taking into account the date of foundation, the sector of activities (two manufacturing and three of services), the number of employees (from 15 to 46), the gender of the successors (three girls and two sons), the turnover (from two to 10 millions), the state of transfer, and the percentage of actions detained.



	<b>Cérami</b>	<b>Sanite</b>	<b>Jetpur</b>	<b>Chocolat</b>	<b>Atti</b>
Number of interviews	4	4	4	4	4
Date of foundation	1975	1980	1999	1987	1981
Sector of activities	Wholesale	Services	Manufacturing	Services, wholesaler	Manufacturing
Number of employees	15	20	46	25	35
Successor	Girl	Son	Girl	Girl	Son
Turnover	2 millions	6 millions	5 millions	4 millions	10 millions
State of transfer	Practically finished	In process	In process	In process	In process
Percentage of actions	Pred.: 100%	Pred.: 100%	Pred.: 63% Succ.: 6% 3 others employees: 31%	Pred.: 100%	Pred.: 100%

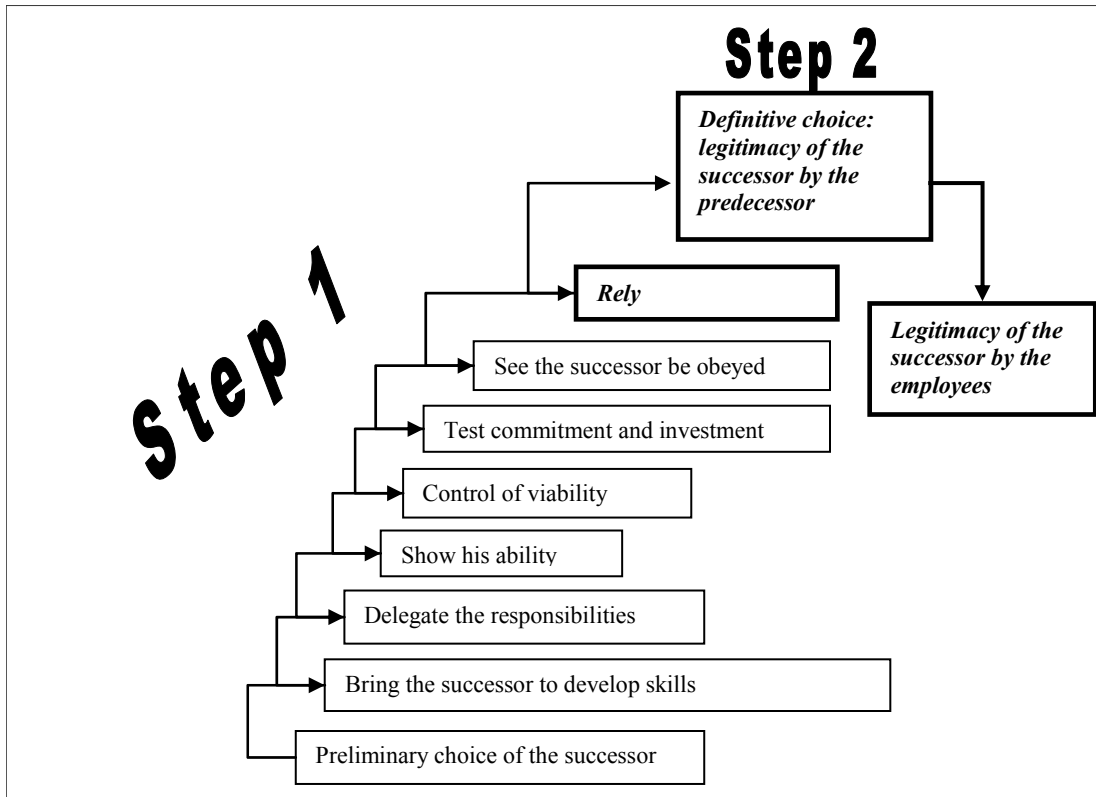
As for the data analysis, we used QSR NVivo 2.0 software. More specifically, we performed thematic analysis of the interviews (Paillé & Mucchielli, 2003). The foundation of analysis with NVivo 2.0 is an approach of decontextualization-recontextualization of the corpus (Paillé & Mucchielli, 2003). This decontextualization consists in bringing out of its context an extract of the discourse to make it semantically independent with the aim of creating categories or themes grouping together all the extracts of a particular subject (Deschenaux & Bourdon, 2005). First, the flexibility of the thematic analysis allowed us to predefine and to organize into a hierarchy the diverse themes or concepts of the abstract which concern the process of succession (Hugron, 1992; Lajeunesse, 1989) and on the dimensions of the concept of legitimacy (Barach et al., 1988).

We also added the themes which appeared during the analysis made with the QSR NVivo 2.0 software. For the validation of these themes, we considered their recurrence, their constancy, and their importance for the referees in the corpus. To satisfy the requirement of confirmation of the data (Yin, 1994), we confronted the various points of view expressed by the various referees on the same subjects. This is why we took into account, when possible, the discourses of four referees from each company. The results follow.

## RESULTS

To gain his legitimacy, the successor has to prove, first, to the predecessor, and then to the employees, that he is capable to assume the tasks of a leader. But it is not certainly sufficient: the father also has to allow the successor to demonstrate his know-how by introducing him to the business and by delegating him responsibilities with the authority inherent to the position, as the latter has to perform. The results show that the predecessors adopt the following behaviors to support the legitimization of their successors (see Figure 3).

**Figure 3**  
**The Relationship between the Adopted Behaviors and the Successor's**



### **Bring the Successor to Develop Skills**

Although they lived their own stories and borrowed the different ways in the creation and the management of their business, the five leaders found important to make acquire various knowledge to their successors. They encouraged them to get an external formation, as a bachelor or a master in management, and to gain some internal experience by means of special projects. In order that the knowledge transfers be concretized, the more often on the technical point of view, the predecessors emphasized the tacit learning within the company.

It is by this educational approach that the successor learns, while looking how his mentor proceeds concretely. We noted that, in the majority of the cases, the mentor was the predecessor, but also sometimes the predecessor's co-workers. The development of the successor's skills contributes to its legitimization: "for her legitimacy, we accepted her naturally because she worked a lot." (E3M-Int-Empl-A, 129) For a referee, "Yes, she knows the company like the back

of her hand and she deserves more than the other children, as X for example.” (E1M-Int-Empl-B, 164) Finally, we noted that the successors also have to spread skills with “value added”, which are directly connected to the business sector of the company to have a determining action to the eyes of the other organization members.

### **Delegate the Responsibilities to the Successor**

When the predecessor is reassured about the successor’s skills, he is going on to the following stage, those to give the successor the responsibilities inherent to the position, while brightening these responsibilities of special projects and by granting the necessary authority for the successor. According to an employee: “when we giving him the big project in the United States, the father was not sure that he would succeed no more than us because we did not rely on him before. He was too young. But he surprised all of us and now, it is him, the position is to him. He is capable.” (E4M-Int-Empl-B, 14)

### **Bring the Successor to Show his Ability**

For the predecessors, the management of the family business is not easy because it contains sometimes numerous unverifiable challenges. Thus, all the observed business managers required from their successors that they made their proofs throughout several stages to be crossed. We noted, similarly to Jolicoeur (1994), three types of proofs: 1) the proofs of interest and investment; 2) the proofs linked to the work; and 3) the proofs of initiative. These proofs constitute any demonstration of capacity and skills on behalf of the successors in the realization of the tasks which are proposed to them. These proofs would be considered as tests or initiation rites to which the successors have to submit themselves and which they have to cross successfully.

First, the proofs of interest and investment are more connected to attitudes and behaviors which concern the successors’ social skills. The predecessors measure the motivation and the efforts which the successors are ready to grant to the company. For example, at 14 years, when there were school strikes with repetition, S1M (a successor of the first enterprise (men)) proved to her parents that she preferred to put a lot of work into the family company rather than to dispose of her time, as the children of her age would make it.

Here is what the referees are thinking: “then she really showed her ability in fact. She really get involved, it is 7 days a week.” (E1M-Int-Empl-B, 194) “It was not annoying that she becomes a partner with us because, in fact, she makes a good work.” (E4MH-Int-Empl-A, 32) With the aim of proving to the others their interest and their degree of investment in the company, it also happen that S1M and S3M often work on the weekend, and sometimes very late in the evening, to complete some priority files.

The proofs of interest and investment are strengthened by the proofs directly linked to the work. The latter concern the tasks attributed to the successors and the way that they have to make them. The work well executed by a successor being an insurance of skills and competencies, these proofs, once coupled to the constancy and a hard work, carry the predecessors to delegate

to many more responsibilities and authority to the successor. A predecessor said to us on this subject: “I left him many more responsibilities because I saw his interest, because he made the work and he took more and more work.” (E5M-Int-Pred, 16)

The proofs of initiative, finally, are the ones which derive from the work achieved by the successors and which result from their initiative to improve or to modify what is already right or still to innovate. They have an important role because they demonstrate, with the eyes of the predecessors, the capacity of entrepreneurship of the successors, the necessary quality in the management and the timelessness of a family business. These proofs of initiative have, in addition, a second function, those to allow the successor to take a length in advance on the father and to build up his own identity as manager. We noted this in the case of S1M of which the employees think that she exceeded the father: “[...] he controls his money, not the work which is made, because he knows that X is very capable of managing everything. The pupil exceeded the master, hard, hard to cook.” (E1M-Int-Empl-B, 353)

### **Exercise a Control of Viability**

For the predecessors, it is very important to make a tight control on the responsibilities and the tasks attributed to the successor, since it is essential for their credibility and those of the successor. Being afraid for the timelessness of their business and not completely relying on their successors, the predecessors set up a program of control on the realizations and the progress of their children. This attitude of control, sometimes source of conflict between successors and predecessors, shows that the successors do not really appreciate a control without confidence.

For a predecessor: “it is all my life this, and I worked hardly, but the young people have difficulty to accept the control. I cannot lose my face in front of my employees.” (E5M-Int-Pred-46) (fifth enterprise (men), interview of the predecessor, discourse no 46) An employee said: “too much control, he is going to exhaust her, but it is what is allowing her to gain legitimacy.” (E3M-Int-Empl-A, 8) “He wants to check everything, to be present everywhere, and it is why he creates frictions sometimes between us. He does not rely, it is very hard.” (E1M-Int-Succ, 58)

### **Test the Commitment and the Investment of the Successor**

In addition to prove that they are capable, the successors had to convince, first, the predecessor and then the employees of their commitment, this attitude which reflects the strength of the link between the successor and his company and its investment within the company. We noted that the predecessor who is completely involved into his company, continuation of himself, a commitment often emotional, expects mostly that the offspring shows this attachment which will carry him to become more identified to his company and to invest more into it.

Thus, they expect that the objectives of the company and the objectives fixed in the case of the special projects are interiorized. Furthermore, the successor has to show a second type of

commitment, called normative commitment, which is an attachment based on a feeling of moral obligation towards the organization. For a successor, “When they see that this initiative that I make is serious, that I take time to sit down to analyze, and that I work 70 hours a week, they are convinced that I am at my place.” (E5M-Int-Succ, 22) (fifth enterprise (men), interview of the successor, discourse no 22) For another one, “At the beginning, I did not want, but he made me feeling the obligation to work with him to save the company, and now I like doing what I do.” (E2M-Int-Succ, 124)

### **See his Successor Be Obeyed**

On the other hand, be obeyed is the second dimension of the legitimacy. It is founded on the faith that the employees have the personal qualities of the successor. According to referees, there is nothing which can prevent them from obeying S1M and S3M. In spite of the fact that S3M is still in training, therefore not totally autonomous, its implication into the company, its distinctive skills make of her a key person: “she has gained her position” said an employee. For the father of E3M, “I totally relied on her from the moment she was capable to be obeyed by her coach.”

### **Make a Definitive Choice of the Successor**

The success of the previous stages brings the predecessor to confirm its choice. This choice raises not only the successor’s skills, but also and especially, a deep sentiment that he is the successor who can make the difference. This contributes to the successor’s legitimacy. From the moment that the successor showed his ability, showed that he is capable to manage and to be obeyed, the predecessors can make their definitive choice and give to the successors the power and the legitimacy. It is from this time that the employees follow the successors. This allows us to understand that the gain of legitimacy is not automatic for the entrepreneurs, but a long-term process (Deschamps & Paturel, 2001).

A father mentioned: “now, my choice is made, I know that it is her since she convinced me. The employees obey her. It was that my fear.” (E4M-Int-Pred, 12) According to a successor, “I was sad when my father did not rely on me. I have to prove and that I prove before was clear in his head. I do not know what he wanted. One time, I wanted to leave.” (E1M-Int-Succ, 69)

### **Give to the Successor the Legitimate Power**

According to our referees, the legitimate power is granted only when the predecessor felt reassured on the potential of his successor to assume the timelessness of the company. The referees also said: “now, it is X who decides on everything. Before, it was the father. He puts complete confidence on her.” (E1M-Int-Empl, 106) “He has some power now and the father often tells us to go to see him.” (E5M-Int-Empl, 21)

## **What Brings the Legitimacy to a Successor?**

For the respondents interviewed, a successor is legitimate when the employees perceive him as having gained his position. So the legitimate successor is distinguished by five characteristics:

- 1) He gains his position not by nepotism but given he has the necessary skills;
- 2) He benefits of a complete confidence from the part of the predecessor;
- 3) He assumes his responsibilities with the authority inherent to the position;
- 4) He is obeyed by the company members, not as a full boss of unhealthy power, but as a person who is a company member and who carries the values of the company; and
- 5) He shows a very clear commitment.

Seen in this way, the legitimacy reveals, not only traditional characteristics, but also charismatic characteristics.

**Gain his position not by nepotism but given he has the necessary skills.** For the predecessors in process of transfer, the fact to plan the succession and to show to the staff and to the collaborators that the choice which is made is a serious decision, allows the referees to grant the legitimacy to the successors. An employee declares: “the successor must be competent to be considered as legitimate, but also because in the family, he is chosen.” (E2M-Int-Empl, 48) Here is the matter of a successor: “to be legitimate, I am. And then, I showed them that I am competent. And then, my brothers did not want the position.” (E3M-Int-Succ, 123)

**Benefit of a complete confidence from the part of the predecessor.** To get the confidence on the part of the predecessor has been a determining element in the gain of legitimacy. For the predecessors, to rely meant making a place for the successors in respecting them, by meaning them that they believed in their capabilities. It was also to bring a contribution to build the visibility of the successors as much within as outside the company, to show that we are proud of them and to give them the right to make mistakes. This confidence being not automatic, the successor had to show his ability and succeed to make the difference.

**Assume his responsibilities with the authority inherent to the position.** The successors had to assume the responsibilities transmitted by their father, by establishing the authority which was conferred to them. Then, the successors have to be obeyed to gain their legitimacy. As the referees said, the successors reached this objective: “when I ask them to make tasks, they make them without talking, without asking questions.” (E1M-Int-Succ, 277) “At the beginning, X was an employee as the others, and actually she manages employees and then she says what to do, and then she has no conflict.” (E3M-Int-Empl-A, 163) “For me, it is simple. She has to get the results and the employees too. Otherwise, this is not working.” (E4M-Int-Pred, 26)

**Show a very clear commitment.** As we underlined previously, the successor has to show two types of commitment, that is, emotional and normative, by assuming the responsibilities which are transmitted to him. It is from this moment that the legitimacy is granted to him, first on the part of the predecessor, and then on the part of the employees. According to an employee: “I relied on him when he agreed not to speak any more of going to the end of the world and to say: yes, now enough ‘niaisage’, I am ready.” (E2M-Int-Empl-A, 128)

## DISCUSSION AND CONCLUSION

This research allowed us to better understand some behaviors of five leaders of SMEs to legitimize their successor. First, let us remind you the importance of the legitimacy during the succession of a company. According to Barach et al. (1988) and Fiegner et al. (1996), the successor’s legitimacy is that for the predecessor and the successor, the latter has the size and the skills of a leader, that he is capable of making the difference into the company; he is perceived by the other family members and by the employees and the other collaborators as having gained his status rather than having inherited from his responsibilities by nepotism.

When we are interested in the empirical validity of these definitions from the results of this research, we must recognize that the understanding of the successors’ legitimization process by the men business managers in context of succession goes beyond the initial concepts of Barach et al. (1988).

The results of this research show that for the referees, the legitimacy of the successor is acquired during a process which does not limit itself to elements such as the power of the dominant, the skills, and the authority revealed by the previous research (Weber, 1971). There would be devolvement of the authority to the successor known by the employees, the obedience of these ones to the directives and the orders of the successor, as well as the demonstration of a very clear commitment on the part of the successor of the company. All these elements would be very important to consider as key factors of the legitimacy. Even if the successor has the stature and the necessary skills, he will not be perceived legitimate if the predecessor does not invest him with the necessary authority to make the decisions and assume his responsibilities.

Another contribution of this study concerns the acquisition of the legitimacy according to a rite of passage, a process during which the predecessor brings his successor to gain skills and to refine them towards value-added skills. Thus, the predecessor delegates responsibilities to the successor and he brings this one to show ability of interest and investment, proofs linked to the work and proofs of initiative. The predecessor then sets up a program of control of the realizations and the progress, and tests the commitment and the investment of the successor.

The predecessor brings his successor to be obeyed, confirms his choice of succession and invests finally the successor of the legitimate power of which this one needs to lead the company. In other words, the predecessors tend to test the skills of the successors by putting them in

conditions of proof and control to verify, first, and then to show to the employees what the successors are capable.

We consider these behaviors as being transactional because in accordance with Bass and Avolio (1994), the predecessors would have proceeded to a management by active exception by checking the activities of the successors and making them passing by a process of proofs. Furthermore, one of the other dimensions of the transactional leadership is the granting of the rewards and penalty. The predecessors effectively tuned their confidence and the legitimacy to the successor from the moment this last one crossed the stages of the examination, the success without which there is no legitimacy. The only dimension of the transformational leadership is related to the fact that all the predecessors brought the successors to develop their skills (intellectual stimulation). How they did not use benevolence and how they granted their confidence and makes their definitive choice only once that the objectives are reached? The results of this research confirm the works of the authors which consider that the men business managers exercise a leadership much more transactional than transformational (Bass & Avolio, 1994; Eagly et al., 2003; Koffi, 2008; Rosener, 1991). This situation then raises new questions: why to follow this transactional process which, not exempt from conflict, often makes the transmission difficult for the successors?

Koffi (2008) and Lorrain et al. (2005) indicate that the difficulties encountered by the predecessors to rely and their desire to control their successor do not bring them to make a success of their managerial transfer of succession. Is it because, as some authors underline (Ahl, 2006; Ely & Padavich, 2007; Guionnet & Neveu, 2004; Héritier, 2005), some male attributes, such as the predisposition to enjoy the power and the emotional censorship, bring the people to be prisoners of a very normative male model.

Another new element comes from what makes up a legitimate successor at the eyes of the employees. It seems evident that from the moment where the successor must succeed to satisfy the requirements of the father, the skills to be acquired will be a function of the father's behaviors. These are the reasons for which the successor has to demonstrate value-added skills, prove without ambiguity that he is really at his place, assert his commitment, and be obeyed. In the analysis of the results, it is interesting to note that the legitimacy, even if it seems traditional (Weber, 1971) at the beginning of the legitimization in the case of the family companies (Cullière, 2008), seems so charismatic (Weber, 1971) throughout the legitimization process with the predecessors.

So, the gain of legitimacy towards the employees is conditional to the gain of legitimacy on the part of the predecessor. It is only when the legitimacy is accorded by the predecessor to the successor that we observe the employees expressing freely their opinions and feelings on the successor. We then attend a phenomenon of social contamination because it is only from the time that the father legitimizes the successor that the others seem to follow.



---

## Research Implications and Limits

The consultants who are working with the business managers in accounting, in law, or in management, for example, or still predecessors or potential successors, can be inspired by the results presented in this paper to adapt their advice and their approach according to the conditions allowing the successors to increase their legitimacy. Indeed, the successor's legitimacy is a determining factor in the success of a succession. Besides, the advice of the consultants has to sensitize the successors in the skills which they have to demonstrate to build their legitimacy. They also have to make sensitive the outgoing leaders in the necessary actions to legitimize their successor at the eyes of the employees and the other people outside (for example, the suppliers, the bankers, etc.).

In spite of the contribution of this research, it is important to underline the limits. Indeed, the main limits are the number of cases studied, the possible ways of the researchers and the referees during the interviews (social desirability), the limits of the researchers to analyze a considerable mass of data, and finally, the fact to have only men predecessors in the sample. Without to want limiting the impact of our results, it would be interesting that subsequent research examine a largest number of cases and distinguish the women of the men business manager among the successors. It would be also interesting to conduct a comparative study (women-men) on the leaders which are leaving in order to verify if there are differences from the point of view of the profitable behaviors adopted throughout the managerial transfer. The lessons learned from all the actors of the succession process would be more complete.

## REFERENCES

- Ahl, H. (2006). Why research on women entrepreneurs need new directions. *Entrepreneurship Theory and Practice*, 30(5), 595-623.
- Alimo-Metcalfe, B. & Alban-Metcalfe, R.J. (2001). The development of a new Transformational Leadership Questionnaire. *Journal of Occupational Psychology*, 74, 1-28.
- Aronoff, C.E. & Ward, J.L. (1994). A golden opportunity for career development. *Nation's Business*, 82, 66-67.
- Astrachan, J.H. & Shanker M.C. (2003). Contribution to the U.S. economy: A closer look. *Family Business Review*, 16(3), 211-219.
- Avolio, B.J. & Bass, B.M. (2002). *Manual for the Multifactor Leadership Questionnaire (Form 5X)*. Redwood City, CA: Mindgarden.
- Bah, T. (2008). La transition cédant-repreneur: une approche par la théorie du deuil. Actes du Congrès annuel de l'AIMS, Nice.
- Barach, J.A., Ganitsky, J., Carson, J.A. & Doochin, B.A. (1988). Entry of the next generation: Strategic challenge for family business. *Journal of Small Business Management*, 26(2), 49-56.
- Bass, B.M. (1990). From transactional to transformational leadership: Learning to share the vision. *Organizational Dynamics*, 18, 19-31.
- Bass, B.M. & Avolio, B.T. (1994). Shatter the glass ceiling: women may make better managers. *Human Resources Management*, 33(4), 549-560.

- Bruce, D. & Picard, D. (2005). La relève, la clé de la réussite: la relève des PME et la prospérité économique au Canada. <http://www.fcei.ca/researchf/reports/rr3007f.pdf>, [accès le 26 avril 2007].
- Brun de Pontet, S., Wrosch, C. & Gagne, M. (2007). An exploration of the generational differences in control held among family businesses approaching succession. *Family Business Review*, 20(4), 337-354.
- Cabrera-Suárez, K. (2005). Leadership transfer and the successor's development in the family firm. *Leadership Quarterly*, 16(1), 71-83.
- Cadioux, L. (2004). *La succession dans les entreprises familiales: une étude de cas sur le processus de désengagement du prédécesseur*. Thèse de doctorat. Université du Québec à Trois-Rivières, Trois-Rivières, Québec.
- Cadioux, L. (2007). Succession in small and medium sized family businesses: Toward a typology of predecessor roles during and after instatement of the successor. *Family Business Review*, 20(2), 95-109.
- Cadioux, L. & Brouard, F. (2009). La transmission des PME: perspectives et enjeux. Québec: Presses de l'Université du Québec.
- Cullière, O. (2008). Une circonscription de la légitimité du repreneur d'entreprise. [http://www.ecole-management-normandie.fr/journee\\_doriot/PDF2008/atelier3/Culliere](http://www.ecole-management-normandie.fr/journee_doriot/PDF2008/atelier3/Culliere), [accès le 24 janvier].
- Cullière (2010). La légitimation du repreneur d'entreprise: quels principes d'action pour les dispositifs d'accompagnement? <http://halshs.archivesouvertes.fr/docs/00/53/43/37/.pdf>, [accès le 29 janvier 2010].
- Deloitte & Touche (1999). *Les entreprises familiales canadiennes sont-elles une espèce en voie de disparition?* [www.deloitte.ca/fr/pubs/tax/familybus/survey\\_f.pdf](http://www.deloitte.ca/fr/pubs/tax/familybus/survey_f.pdf), [accès le 28 novembre 2004].
- De Massis, A., Chua, J.H. & Chrisman, J.J. (2008). Factors preventing intra-family succession. *Family Business Review*, 21(2), 183-199.
- Deschamps, B. (2000). *Le processus de reprise d'entreprise par les entrepreneurs personnes physiques*. Thèse de Doctorat en Sciences de Gestion, Université Grenoble 2.
- Deschamps, B. & Paturel, R. (2001). *Reprendre une entreprise... saine ou en difficulté*. Paris: Dunod.
- Deschenaux, F. & Bourdon, S. (2005). *Introduction à l'analyse qualitative informatisée à l'aide du logiciel QSR Nvivo 2.0*. Les cahiers pédagogiques de l'Association pour la recherche qualitative, Sherbrooke, Québec.
- Eagly, A.H., Johannesen-Schmidt, M.-C. & van Engen, M.L. (2003). Transformational, transactional, and laissez-leadership styles: A meta-analysis comparing women and men, *Psychological Bulletin*, 129(4), 569-591.
- Ely, R. & Padavich, I. (2007). A feminist analysis of organizational research on sex differences. *Academy of Management Review*, 32(4), 1121-1143.
- Family Firm Institute (FFI) (2003). *Facts and perspectives on family business*, [http://www.ffi.org/looking/fbfacts\\_us.html](http://www.ffi.org/looking/fbfacts_us.html), accessed 20 november 2004.
- Fiegenger, M.K., Brown, B.M., Prince, R. All. & File, K.M. (1996). Passing on strategic vision: favoured modes of successor preparation by CEOs of family and nonfamily firms. *Journal of Small Business Management*, 34(3), 15-26.
- Garcia-Alvarez E, Lopez-Sintas, J. & Saldana Gonzalvo, P. (2002). Socialization patterns of successors in first- to second-generation family businesses. *Family Business Review*, 5(3), 189.
- Grenier, C. & Josserand, E. (1999). Recherche sur le contenu et recherche sur le processus, In R.-A. Thiétart (dir.), *Méthodes de recherche en management* (p. 104-136), Paris: Dunod.
- Guionnet, C. & Neveu, E. (2004). *Féminin/Masculin. Sociologie du genre*. Paris: Armand Colin.
- Haberman, H., Sharon, M. & Danes, S.M. (2007). Father-Daughter and Father-Son Family Business Management Transfer Comparison: Family FIRO Model Application. *Family Business Review*, 20(2), 163.
- Haddadj, S. & D'Andria, A. (2001). Mesurer les phénomènes agissant sur la transmission des PME familiales. *Revue Française de Gestion*, 132, 11-22.
- Handler, W.C. (1990). Succession in family firms: A mutual role adjustment between entrepreneur and next-generation family members. *Entrepreneurship Theory and Practice*, 15(1), 37-51.

- Héritier, F. (2005). *Hommes, femmes, la construction de la différence*. Paris: Le Pommier, Cité des sciences et de l'industrie.
- Hlady-Rispal, M. (2002). *La méthode des cas: application à la recherche en gestion*. De Boeck Université.
- Hugron, P. (1992). *L'entreprise familiale. Modèle de réussite du processus successoral*. Monographie, Institut de recherches politiques et les Presses HEC.
- Jolicoeur, A. (1994). *La succession dans les entreprises familiales: un processus de communication*. Mémoire de maîtrise, Université de Montréal, Montréal, Québec.
- Koffi, V. (2008). *L'intégration du successeur dans les PME familiales: une étude de cas comparative des stratégies des prédécesseuses et des prédécesseurs*. Thèse de doctorat inédite. Trois-Rivières, Université du Québec à Trois-Rivières.
- Koffi, V. & Lorrain, J. (2005). L'intégration du successeur dans l'équipe de gestion des entreprises familiales: le cas des femmes chefs d'entreprise. *Revue Internationale PME*, 18(3-4), 73-92.
- Lajeunesse, C. (1989). *La succession managériale dans la PME familiale: études de règne-conjoint*. Mémoire de maîtrise, École des Hautes Études Commerciales, Montréal, Québec.
- Lansberg, I. & Astrachan J.H. (1994). Influence of family relationships on succession planning and training: The importance of mediating factors. *Family Business Review*, 7(1), 39-59.
- Le Breton-Miller, I., Miller, D. & Steier, L. (2004). Toward an integrative model of effective FOB succession. *Entrepreneurship Theory and Practice*, 28(4), 305-328.
- Lorrain, J., Powers, T. & Koffi, V. (2005). La relève entrepreneuriale dans les entreprises: étude de trois régions du Québec. Rapport inédit, Ministère du Développement économique, de l'Innovation et de l'Exportation, Québec.
- Mitchell, J.R., Hart, T.A., Valcea, S. & Townsend, D.M. (2009). Becoming the boss: discretion and postsuccession success in family firms. *Entrepreneurship Theory and Practice*, 33(6), 1201-1218.
- OSEO (2005). *La transmission des petites et moyennes entreprises: l'expérience d'OSEO bdpme*, réf. 6903-02.
- Paillé, P. & Mucchielli, A. (2003). *L'analyse qualitative en sciences humaines et sociales*. Paris: Armand Colin.
- Petit, V. & Mari, I. (2009). La légitimité des équipes dirigeantes: une dimension négligée de la gouvernance d'entreprises. *EDHEC*.
- Richer, F., St-Cyr, L. & Youssef, L. (2004). La transmission d'entreprise au Québec: des stratégies diversifiées. *Revue Internationale de Gestion*, 29(3), 95-102.
- Riot, E., Ramanantsoa, B. & Krieger, E. (2007). La reprise d'entreprise à l'aune de l'analyse du récit. *Gestion 2000*, No 3, 125-140.
- Rosener, J. (1991). Ways women lead. *Havard Business Review*, 69(1), p. 150-4, 156, 158-60.
- Sathe, V. (1985). *Culture and related corporate realities*. Homewood, IL: Irwing Inc.
- Sharma, P. (2004). An overview of the field of family business studies: current status and directions for the future. *Family Business Review*, 17(1), 1-36.
- St-Cyr, L. & Richer, F. (2005). La planification du processus de transmission dans les PME québécoises. *Revue Internationale PME*, 18(3-4), 51-71.
- Venter, E., Boshoff, C. & Maas, G. (2005). The Influence of Successor-Related Factors on the Succession Process in Small and Medium-Sized Family Businesses. *Family Business Review*, 18(4), 283-303.
- Ward, J. (1987). *Keeping the family business healthy*. San Francisco: Jossey-Bass.
- Weber, M. (1971). *Économie et société*. Paris, FR: Pilon.
- Yin, R.K. (1994). *Case study research, design and methods*. Applied Social Research Methods Series, 5 (2<sup>e</sup> éd.), Thousand Oaks, CA: Sage Publications.



# SMALL BUSINESS AND OBAMACARE: THE NEW LAW'S RULES DO APPLY "TO THE VAST MAJORITY OF ALL BUSINESSES"

Robert J. Lahm, Jr., Western Carolina University

## ABSTRACT

*Obamacare, or officially The Patient Protection and Affordable Care Act (abbreviated PPACA or ACA), has been a contentious topic in the public sphere and the subject of intense coverage by the popular media. In the days immediately following the launch of HealthCare.gov, the website which has been intended as the destination for consumers and small businesses to shop for and purchase (supposedly) affordable health care insurance coverage, it became obvious that the site's capacity to serve users was overwhelmed by technical and design flaws. Widespread instances of "sticker shock" have been reported by those who have managed to shop for or obtain insurance, while at the same time millions of cancellation notices have been sent to consumers, and it is anticipated that millions more cancellations will follow, affecting both small and large employers. Some have dismissed the notion that these problems are anything more than short-term stumbling blocks that will be overcome, impacting only a small percentage of the population as a whole. However, findings in this paper suggest that the opposite may be true, as many uncertainties abound and appear to already be leading to domestic and more than likely, international economic consequences.*

## INTRODUCTION

The idea behind the Affordable Care Act (ACA) also known as Obamacare or by its full name, The Patient Protection and Affordable Care Act (P.L. 111-148) ("Patient Protection and Affordable Care Act," 2010), was to provide health care coverage for all Americans, and to do so affordably. The Health Care And Education Reconciliation Act of 2010 (Public Law 111 - 152) ("Health Care And Education Reconciliation Act," 2010) added to the already lengthy and legislation. Infamously, Nancy Pelosi, Speaker of House, has been widely quoted after stating: "But we have to pass the bill so that you can find out, what is in it—away from the fog of the controversy" (Pelosi, 2010). However, notwithstanding the ACA's passage, it has remained embroiled in controversy ever since.

A major challenge began when the *National Federation of Independent Businesses* (NFIB), and twenty-six states, along with private individuals challenged the constitutionality of the law in an action against the U.S. Departments of Health and Human Services (HHS), Treasury, and Labor, and their respective Secretaries before the Supreme Court. The law was upheld, by a 5 to 4 vote, but only after the Court determined that the Individual Shared

Responsibility Payment (which had been labeled in the original language of law as a “penalty”) could effectively be considered a tax, further reasoning: “The payment is not so high that there is really no choice but to buy health insurance; the payment is not limited to willful violations, as penalties for unlawful acts often are; and the payment is collected solely by the IRS through the normal means of taxation” (“National Federation of Independent Business v. Sebelius, Slip Opinion, No. 11–393,” 2012, p. 4).

Surveys from reputable research organizations show that small businesses are reacting to the ACA by reducing hours and putting off hiring decisions. As well, large employers such as Home Depot and Trader Joe’s are cutting health benefits for part-timers while others such as IBM are removing retirees (Whelan, 2013) while United Parcel Service (UPS) announced that it was removing approximately 15,000 spouses employees’ from its company health plan (Wieczner, 2013). “By denying coverage to spouses, employers not only save the annual premiums, but also the new fees that went into effect as part of the Affordable Care Act” (*Ibid.*). Besides legal challenges, implementation of Obamacare has been accompanied by a government shutdown (Rinaldi, 2013), numerous other delays, exemptions (Pfeiffer, 2013), waivers (Radnofsky, Weaver, & Needleman, 2013), and millions of existing policy cancellation notices (Barrineau & Dastagir, 2013; Roy, 2013a).

Recently, due to problems with the HealthCare.gov website, it was announced that the Small Business Health Option Program (SHOP) marketplace exchanges on the HealthCare.gov site would be delayed for another year until November 2014 (Taulli, 2013), thereby exacerbating an environment of economic uncertainty (Banjo, 2013; Rogers, 2012; Straud, 2013). While these website problems were at first passed off as glitches, through a series of hearings, investigations, and media reports, it became obvious that a plethora of problems existed, including security vulnerabilities that put users’ personal privacy at risk. Despite the fact that the website has not been fully functioning, and following a two month delay for repairs (the administration backpedaled to suggest that fully functioning meant that it would work for a majority of users), individuals are still threatened by IRS imposed penalties if they fail to sign-up. The law’s complexity is such that consumers and small businesses will be subjected to a difficult, underestimated, and costly compliance burden (Lahm, 2013) as they struggle to navigate numerous difficult-to-interpret provisions (Amato & Schreiber, 2013; Coombs, 2013; Neiburger, 2011), requiring significant amounts of assistance from tax and accounting professionals (Amato & Schreiber, 2013).

With the above as a backdrop, scholars in the business disciplines have not yet made significant contributions to the literature with respect to the impacts of Obamacare on entrepreneurs and small businesses. Given the importance of small businesses and their contributions to the U.S. economy, and hence the world economy (Boot, 2010; Faal, 2013), substantial and ongoing research efforts are warranted. As such, this present paper constitutes one such effort to explore ramifications of the law and to present conceptual frameworks.

---

## REVIEW OF EXISTING LITERATURE

A literature review was conducted at the onset of this research using the following Ebsco databases simultaneously: *Academic Search Complete*, *Business Source Complete*, *Entrepreneurial Studies Source*, and *Small Business Reference Center*. Using the search terms “small business” and “Obamacare” combined, 120 items were returned as initial search results. However, upon applying filters to select for scholarly-peer reviewed articles, results were narrowed significantly to two articles. One of these was an article published in the *Journal of Law, Medicine & Ethics*, and the other was published in *Business Horizons* (business law and ethics section). A subsequent search using the proper name, “Affordable Care Act,” and “small business” in combination returned more robust results with the filter applied for scholarly-peer reviewed articles, identifying 62 articles.

Many of these, judging by the journal titles in which they appeared and through sampling content, were focused on scholars or professionals in health care, law, and accountancy. Examples included: *Health Affairs* (several), *New England Journal of Medicine*, *Benefits Quarterly*, *Journal of Health Politics, Policy & Law*, and *Health Services Research*. Some publications, notwithstanding the application of the search results filter for scholarly-peer reviewed articles, were targeted to professionals in law and accounting, such as *CPA Journal*. While such scholarship as suggested above is appreciated and served to inform that discourse has begun among some researchers, given the importance of Obamacare and its potential impact on small businesses and the economy, the need for a far more robust flow of research would seem to be obvious. For purposes of comparison, the list maintained by Katz (2012) “*Core publications in entrepreneurship and related fields: A guide to getting published*,” was used to arrive at the conclusion that thus far lacking in the literature are contributions that are specific to the discipline(s) of small business and entrepreneurship.

Notwithstanding the above described lack of scholarly literature, an almost extraordinary amount of coverage exists flowing from the news media, blogs and other websites, and business publications such as *Entrepreneur*, *Business Week*, *Wall Street Journal*, and *Forbes*. As a result of these initial search efforts it became clear that an exploratory approach under a qualitative research frame was justified. Cultural artifact(s) may be incorporated as data sources in qualitative designs (Fiske, 1994; Hodder, 1994). Data sources may include audio, video, artwork, or still photography; direct observations or interviews; and documents of various types such as field notes, diaries and personal letters, biographies, or those from public sources, (Creswell, 1994, pp. 148-149).

Accordingly, the search engines *Google* and *Google Scholar* were employed to identify and collect additional artifacts for review. Since Obamacare and its impact has been the subject of enormous controversy and discourse in the public sphere, plentiful artifacts were identified for review and further analysis. In many instances popular media might refer to government documents, polls, studies, or other seminal sources, and where possible (media are notorious for

referring to but not fully citing original sources) these seminal sources were sought so as to be utilized directly. A database of over 170 artifacts was collected, keeping in mind that some items are voluminous, individually. For example, The Patient Protection and Affordable Care Act (Public Law 111-148) is a 906 page pdf document (as cited in the reference list). The Health Care And Education Reconciliation Act of 2010 (Public Law 111 - 152) added another 55 pages to amend the original legislation, and a document from the U.S. House of Representatives, Office of the Legislative Counsel, which compiled these two legislative acts, is 974 pages long ("Office of the Legislative Counsel Compilation of Patient Protection And Affordable Care Act," 2010).

### **THE SMALL BUSINESS ECONOMY AND RESPONSES TO OBAMACARE**

The 2007 recession hit businesses hard (Kobe, 2012), and even though recent years have shown some improvement, the U.S. economy has yet to fully recover. The U.S. Small business Administration's (SBA) Office of Advocacy publication entitled, *The Small Business Economy 2012*, is part of an ongoing series of reports (released over the past three decades) which document trends on financing, ownership, employment and other characteristics. In a cover letter introducing this latest report, it was observed that "the effects of the most recent downturn are still being felt. The number of business births and their associated employment remain below pre-downturn levels and employment gains have been muted compared with previous downturns" ("The small business economy," 2012). Small business share of Gross Domestic Product (GDP) was above 48 percent in 2002 but plunged to about 44.5 percent in 2010. (Kobe, 2012). Although challenged by the continuing repercussions of the downturn, small firms were nevertheless responsible for creating almost two thirds of net new jobs between 1993 and 2010. In numbers, 11.8 million of the 18.5 million net new jobs created during this period were generated by small firms ("Frequently Asked Questions about small business," 2012).

Findings from a survey released by the International Foundation of Employee Benefit Plans (IFEBP) for which it collected data in March of 2013 indicated that 16% of respondents have adjusted or plan to adjust hours for employees in order to lower the number who are classified as full-time workers (Mrkvicka, Held, Stich, & Kolsrud, 2013). A Gallop poll of small business owners in April 2013 indicated that slightly more than four in ten (41 percent) have held off on hiring new employees and nearly the same number (38 percent) "pulled back on plans to grow their business" (Jacobe, 2013). Approximately two months after the Gallop poll's release, the U.S. Chamber of Commerce released findings indicating that "one-half of small businesses say that they will either cut hours to reduce full time employees OR replace full time employees with part-time workers to avoid the mandate" ("U.S. Chamber of Commerce Q2 2013 small business survey," 2013).



## MORE THAN MERE GLITCHES: MAJOR FLAWS PLAGUE HEALTHCARE.GOV

The healthcare insurance exchange marketplace ("Health insurance exchanges: An update from the administration," 2013; Siegel Bernard, 2013; "What does Marketplace health insurance cover?," 2013) that was created under Obamacare for consumers and small businesses via a new HealthCare.gov website was to open October 1, 2013. In the site's first two days of operation it received a reported 7 million visitors (Chumley, 2013). However, the site was clearly not ready to service users. While at first freezing (Pearson, 2013; Wallace, 2013) and other issues were attributed to a large volume of site traffic and "glitches," (Chumley, 2013; Howell, 2013; Young, 2013) it was later determined that major design flaws and other problems plagued the site (Wallace, 2013). According to a *National Public Radio* (NPR) report, a programmer who built the campaign website for President Obama in 2008 stated that "the HealthCare.gov system could have been built for a tenth of the cost had the government hired better talent—and taken a more open, agile approach to software development" (Hu, 2013).

Following the initial launch problems a new self-imposed deadline for fixing the HealthCare.gov site by the end of November 2013 was announced, but during the preceding weeks leading up to that deadline, the Obama administration began to issue statements signaling lowered expectations, to the effect that the site would be functioning better for the vast majority of users ("Health insurance exchanges: An update from the administration," 2013; Pearson, 2013). "After initially saying the problems were caused by overwhelming interest in Obamacare that swamped the website's computer systems, administration officials acknowledged the issues ran deeper and ordered a 'tech surge' to address them" (*Ibid.*).

Immediately after the new self-imposed deadline, the site was said to be functioning much better, but still in need of additional repairs. Despite these issues, an individual responsibility provision under the law requires almost all Americans to obtain health insurance by January 1, 2014, and to sign-up by December 15, 2013, in order to do so (notwithstanding that the site has not been fully functioning during a two month period between October 1, 2013, and November 1, 2013, individuals recently received an eight day extension to sign-up by December 23, 2013).

A *60 Minutes* television news report featuring Jeff Bezos, founder of Amazon.com, suggested "that more than 300 items a second" (Rose, 2013) would be ordered on the company's website on Cyber Monday (the day after Thanksgiving weekend, 2013). At such a transaction speed, in one hour the site would handle over one million transactions (The usage rate analysis here was first inspired by a blog post entitled "Healthcare.flub v. Black Friday & Cyber Monday: Walmart & Amazon show up Obama" (Schlussel, 2013). In contrast to such speeds, the sign-up estimate (i.e., goal) for Obamacare in 2014 was 7 million individuals ("Health insurance marketplace: November enrollment report," 2013) and the approximately 106,185 individuals who have selected a Marketplace plan according to a November 2013 report the Department of

Health and Human Services (*Ibid.*). As reported by *The Washington Post*, the administration's measures of success were for the HealthCare.gov website to be able to handle 50,000 concurrent users and 800,000 visitors per day (Kliff, 2013). However, beyond issues with the website, the law itself has been problematic on many additional fronts in terms of consequences.

### **SECURITY ISSUES THREATEN PRIVACY: POSE RISK OF IDENTITY THEFT**

The severity of the security issues associated with the HealthCare.gov website has been the topic of numerous media reports. The site's users may be subjected to the exploits of hackers and identity thieves. Roy (2013b), quoting a former Obama administration official, reported that the site "will, unless delayed and fixed, inflict on the public the most widespread violation of the Privacy Act in our history." According to Howell (2013), "vendors have said the Obama administration did not test the system 'end to end' until days before its launch," and a Centers for Medicare and Medicaid Services (CMS) memo indicated that as of Sept. 27, 2013, the HealthCare.gov website had not concluded security testing.

Besides security problems on the site itself, issues with regard to Navigators have also arisen. Sequentially quoting key phrases from the law directly, health exchange Navigators are to:

Conduct public education activities to raise awareness of the availability of qualified health plans; distribute fair and impartial information concerning enrollment in qualified health plans, and the availability of premium tax credits; facilitate enrollment; provide referrals; [and] provide information in a manner that is culturally and linguistically appropriate to the needs of the population being served. ("Patient Protection and Affordable Care Act," 2010, 124 STAT. 181)

Concerns about criminal background checks not being conducted (or required) were raised in U.S. House of Representatives Energy and Commerce Committee testimony given by Health and Human Services (HHS) Secretary Kathleen Sebelius, in connection with the fact that navigators handle sensitive private data ("PPACA implementation failures: Answers from HHS," 2013). Individual navigators have been accused of encouraging health plan applicants to misrepresent information such as income earned on-on-the-side (which might diminish tax credits and subsidies these applicants could receive), and allegations of cronyism on the part of the administration in the awarding of grants to firms that provide navigator services have been made (Fund, 2013; Howerton, 2013). Further allegations of cronyism have been made with regard to the awarding of HealthCare.gov website development contracts (Ferenstein, 2013).

## THE COMING STORM OF BUSINESS POLICY CANCELLATIONS

“Businesses will not take much comfort from the passage of this ‘historic’ health care bill. The President and many lawmakers in Washington are consistently proposing and passing legislation that hurts these businesses, and Obamacare is one more example” (Ligon, 2010). According to research conclusions from the NFIB:

Congress chose to make insurance coverage the centerpiece of the ACA; cost was largely ignored. In fact, in its zeal to expand and improve (?) coverage, Congress purposefully took steps to exacerbate the cost pressures that small-business owners face. Required new benefits, new taxes rolled into premiums that affect only small businesses and individuals, and elimination of low cost plans are exhibits one, two, and three. (Dennis, 2013, p. 29)

Referring to Dennis’s exhibits one and three, required new benefits and the elimination of low cost plans, herein lies the source of tremendous controversy as the connection has been made that following individual policy cancellations there may come cancellations for small and large employers. All of these cancellations are because the new health care law was, by design, meant to require policy providers to incorporate a core set of benefits including ambulatory and emergency services; hospitalization; maternity, newborn care, and pediatric services; mental health and substance use; rehabilitative and habilitative services and devices; laboratory services; preventive and wellness services; chronic disease management; and prescriptions (“What does Marketplace health insurance cover?,” 2013).

Notwithstanding that this core set of benefits has been described as that which differentiates a so-called “junk” plan from a “quality” plan (“Obamacare ‘horror’ story turns out to be Obamacare success story,” 2013), an underlying motive is readily apparent. When insureds pay for benefits in coverages areas where it is obvious that no claim is going to occur, other insureds who would likely make claims under one of these coverage areas, in effect, become subsidized. Maternity and newborn benefits along with pediatric services for a single (childless) male would be prime examples. Another part of this aforementioned design by the law’s authors was intended to alter the risk pool as a whole such that those who were young and less likely to be sick would subsidize those who were previously uninsured (and perhaps uninsurable due to preexisting conditions).

However, prices on exchanges generally appear to be higher for many, including younger individuals, and findings from research by Buchmueller (2012) demonstrated that “younger, healthier consumers are more willing to switch health plans in response to a change in prices,” i.e., if prices increase. According to a report by the Cato Institute, indicating widespread “sticker shock,” was being felt by consumers: “Comparisons of exchange premiums with those found prior to October 1 show that premiums are higher now in at least 45 states, in some cases as

much as 256 percent higher. As predicted, the young and healthy are seeing the biggest increases” (Tanner, 2013). When it boils down to it, Obamacare is a design that portends a transfer of wealth using a surrogate currency in the form of health care dollars taken from the covered and given to the uninsured:

The elimination of cost-sharing for some services in non-grandfathered plans, leads to transfers of wealth from premium payers overall to individuals using covered services. Once pre-existing conditions are fully prohibited and other insurance reforms take effect, the extent to which individuals are enrolled in grandfathered plans could affect adverse selection, as higher risk plans relinquish grandfather status to gain new protections while lower risk grandfathered plans retain their grandfather status. This could result in a transfer of wealth from non-grandfathered plans to grandfathered health plans. (in Table 2, "Rules and Regulations," 2010, p. 34548)

Much of the controversy with regard to cancellations is directly associated with well-publicized and oft-repeated presidential campaign promises (and others made afterwards) to the effect that those who liked their existing health insurance policies and doctors, could keep them. For instance, while a candidate for a second term in office, Mr. Obama stated: “If Americans like their doctor, they’ll be keeping their doctor. You like your plan? You’ll be keeping your plan” (Obama, 2010). Congress did in fact allow for the possibility that some plans could remain in effect as “grandfathered” (Myers, 2013) policies; yet, at the same time it may have known (or arguably should have known) that this would be an ineffectual:

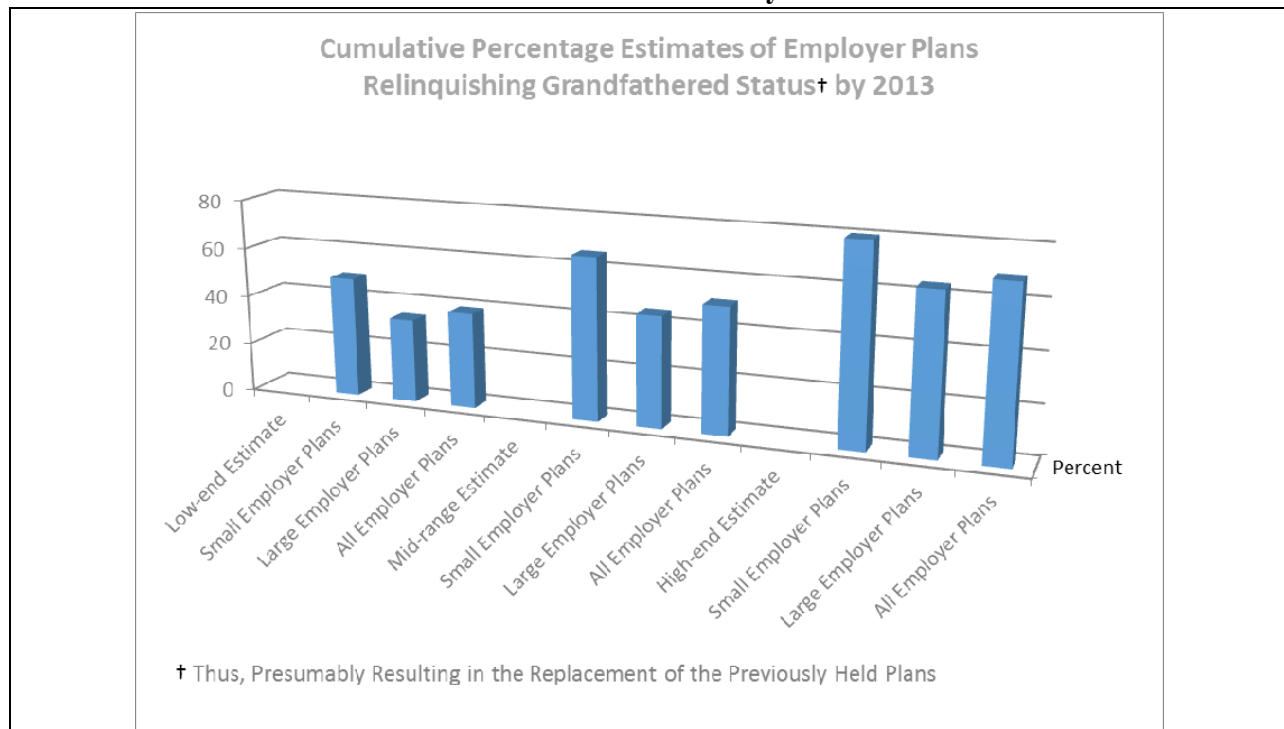
At issue is a so-called “grandfather” clause in the law stating that consumers would have the option of keeping policies in effect as of March 23, 2010, even if they didn’t meet requirements of the new health care law. But the Department of Health and Human Services then wrote regulations that narrowed that provision, saying that if any part of a policy was significantly changed after that date — the deductible, co-pay, or benefits, for example — the policy would not be grandfathered. (Ibid.)

According to estimates in a *Federal Register* table ("Rules and Regulations," 2010, p. 34553), small employers that would no longer have grandfathered plans by 2013 were estimated as follows: low-end, 49%; mid-range, 66%; and high-end, 80%. For purposes of these estimates small employers were defined in the footnotes to this table as those with 3 to 99 full-time employees, and larger employers as those with 100 or more employees. Further analysis reported in the *Federal Register* suggested that “beginning in 2014, premiums can vary more widely for grandfathered plans than for non-grandfathered plans for employers with up to 100 employees in many States” ("Rules and Regulations," 2010, p. 34549), and:

This scenario likely will encourage plan sponsors and issuers that cover higher-risk groups to end grandfathered health plans, because the group would be folded into the larger, lower-risk non-grandfathered pool. Depending on the size of the grandfathered health plan market, such adverse selection by grandfathered health plans against non-grandfathered plans could cause premiums in the exchanges to be higher than they would have been absent

grandfathering. (*Ibid.*) Figure 1 illustrates 2013 estimates for small employers, large employers, and all employers respectively that may be relinquishing grandfathered health insurance plans. Relinquishing grandfathered plans is another way of saying that these employer plans would presumably be cancelled and replaced with new plans that are compliant with Obamacare's minimum standards.

**Figure 1: Cumulative Percentage Estimates of Employer Plans Relinquishing Grandfathered States by 2013**



Source: Derived from *Federal Register*/Vol. 75, No. 116/Thursday, June 17, 2010/Rules and Regulations, p. 34553. Retrieved November 10, 2013, from <http://www.gpo.gov/fdsys/pkg/FR-2010-06-17/pdf/2010-14488.pdf>

So, questions to the effect of what did the president know and when he knew it have arisen, leading many to challenge the president's credibility (Roy, 2013a).

**NO, THE NEW LAW'S RULES DO APPLY "TO THE VAST MAJORITY OF ALL BUSINESSES"**

Pagliery (2013) argued, "it's been uttered by every opponent of health care reform: Obamacare will kill small businesses. But the new law's rules don't apply to the vast majority of small businesses." The basis for such an argument appears at first to be a rational analysis:

As of 2010, there were roughly 5.7 million small employers, defined as those with fewer than 500 workers. Some 97% of them have fewer than 50 employees. That means Obamacare's employer mandate applies only to 3% of America's small businesses. That's about 200,000 companies....Why so much focus on so few firms? (*Ibid.*)

However, the new laws rules *do apply* to the vast majority of all businesses, in several ways that have not as yet garnered attention in the popular media as it has recently focused on “glitches” (Chumley, 2013; Howell, 2013; Radnofsky et al., 2013; Young, 2013) with the launch of the HealthCare.gov website. The basis for the counter argument presented here starts with *Frequently Asked Questions* (2012) data (For purposes of simplicity and clarity, narrative discussion under counter argument items “First” and “Second” is primarily guided by the cited SBA Frequently Asked Questions (FAQ) document (2012), which was the latest available when this manuscript was prepared. Sources besides the FAQ document are specifically cited) from the U.S. Small Business Administration (SBA):

First, the definition of small employers is acknowledged as those with “fewer than 500 workers [employees, per the SBA]” (*Ibid.*, Pagliery), and yes, “the [SBA] Office of Advocacy defines a small business as an independent business having fewer than 500 employees.” However, the figure “roughly 5.7 million small employers” does not factor in nonemployers. Thus, to add perspective to this 5.7 million number, “in 2010 there were 27.9 million small businesses, and 18,500 firms with 500 employees or more.” Table 1 provides greater detail in connection with the 5.7 million small employers.

<b>EMPLOYMENT SIZE</b>	<b>NUMBER OF FIRMS</b>	<b>NUMBER OF ESTABLISHMENTS</b>	<b>EMPLOYMENT</b>
0-4	3,575,240	3,582,826	5,926,452
5-9	968,075	982,019	6,358,931
10-14	407,404	425,641	4,767,288
15-19	209,685	227,021	3,521,097
20-24	120,787	137,465	2,635,563
25-29	80,526	95,098	2,161,156
30-34	58,557	72,882	1,865,736
35-39	42,860	56,323	1,580,717
40-44	33,697	46,334	1,410,309
45-49	26,529	38,467	1,242,981
<b>TOTAL</b>	<b>5,523,360</b>	<b>5,664,076</b>	<b>31,470,230</b>

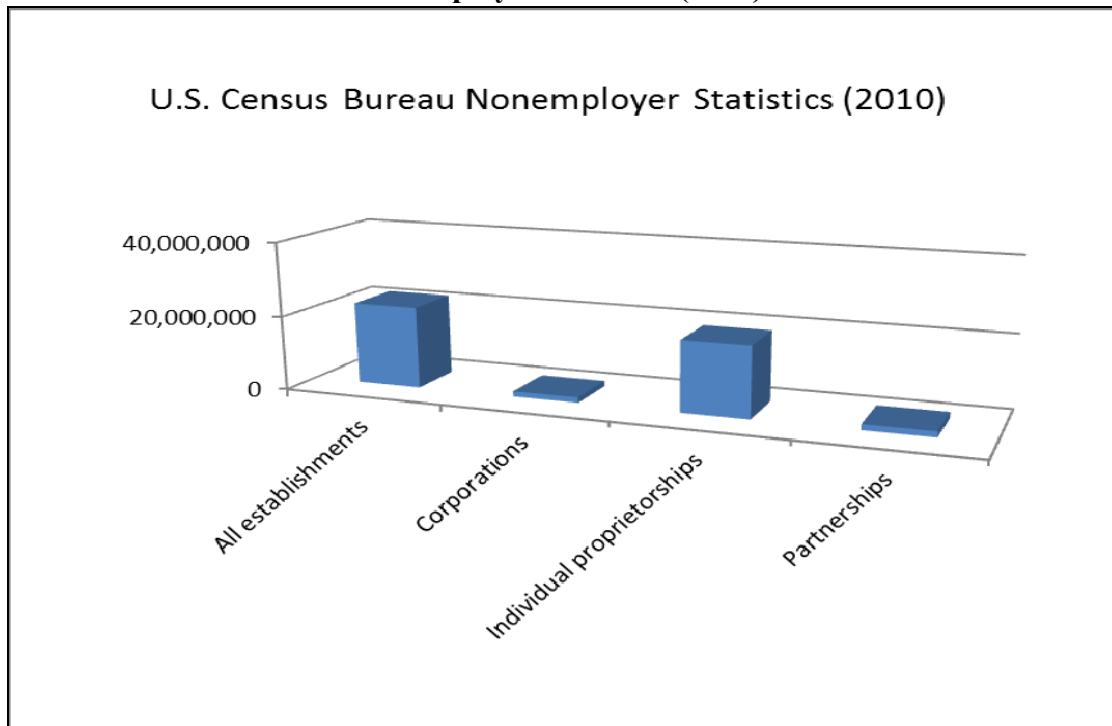
Source: Derived from U.S. Census Bureau Number of Firms, Number of Establishments, Employment, and Annual Payroll by Small Enterprise Employment Sizes for the United States, NAICS Sectors: 2010. Retrieved November 30, 2013, from [http://www2.census.gov/econ/susb/data/2010/us\\_naicssector\\_small\\_empsize\\_2010.xls](http://www2.census.gov/econ/susb/data/2010/us_naicssector_small_empsize_2010.xls)

Second, “over three-quarters of small businesses were nonemployers.” To be more precise, 78.5 percent of small businesses, or almost eight out of ten small businesses, are nonemployers (2010 data, so as to be consistent with that used in Pagliery’s argument). 94 percent of these nonemployers were sole proprietors and partnerships in 2010 (comprised of 86

percent sole proprietorships and 7 percent partnerships). While Pagliery or others might analogously argue, why focus on such very small firms?, it is important to note that these firms can be conceptually viewed as the seeds we have sown in terms of our culture at large and its potential economic future. They might hire, if only they were nurtured and could grow. Nonemployers would seem at least to be more likely job creators than those who consider themselves to be better suited to works as an employee. According to a report on small business Gross Domestic Product from the SBA:

Small businesses create many more jobs than do large businesses...Quite logically, small businesses are creating the vast majority of the jobs that come about due to new businesses opening because few businesses have 500 or more employees when they open their doors. These young businesses represent the volatile edge of entrepreneurship where new ideas and concepts are tested. (Kobe, 2012).

**Figure 2: U.S. Census Bureau Nonemployer Statistics (2010)**



Source: Derived from U.S. Census Bureau nonemployer statistics. (2013, August 12). Retrieved September 27, 2013, from <http://www.census.gov/econ/nonemployer/>

Further, as of “March 2011, a significant number of the self-employed, 5.5 percent or about 900,000, had been unemployed in the previous year.” “However, just about the time when some of these individuals have converted from being unemployed (perhaps chronically) to self-employed (perhaps tenuously), along comes the implementation of Obamacare” (Lahm, 2013).

So, while small firms may be nonemployers in the beginning, they at least have the potential for growth and for hiring others. According to U.S. Census Bureau nonemployer statistics, in 2010 there were a total of 22,110,628 establishments, comprised of: 1,430,531 corporations, 19,112,075 individual proprietorships, and 1,568,022 partnerships (see Figure 2, including source notes).

Third, the employer mandate applies to businesses with 50 or more full-time equivalent employees (FTEs)—which is very different than simply “fewer than 50 employees” (*Ibid.*, Pagliery), because there is a new added burden of performing calculations imposed on small businesses (Amato & Schreiber, 2013; Coombs, 2013) for purposes of estimating penalties (also known as Employer Shared Responsibility Payments due to the Supreme Court ruling discussed above). This also helps to explain why some small businesses that are close to the threshold are cutting employees and reducing hours (Graham, 2013; Mrkvicka et al., 2013; Shane, 2013). According to the IRS, “all employees of the eligible small employer are taken into account when determining FTEs and average annual FTE wages” (“Small business health care tax credit questions and answers: Determining FTEs and average annual wages,” 2013).

These often complex calculations must factor in part-time and seasonal employees (“Full-time equivalent employee calculator for employer shared responsibility,” 2013). While the task at hand (calculating FTEs) may appear to be a matter that involves head counts, hours worked, and pay, other aspects of the law such as navigating ownership and control issues due to non-aggregation rules typically require professional help (Lawson & Nelson; Neiburger, 2011). “Small businesses do not have the capacity to easily take on additional administrative complexities” (Ligon, 2010). As a whole, Obamacare places new burdens and expenses for businesses (to absorb or pass on to consumers), even if a boon to accounting and law firms (Lahm, 2013). For instance, effective January 2013, W-2 tax forms were required to show a line item indicating the amount of any benefits an employee received in the form of employer sponsored health care (Klein, 2012). “Small companies may face an increase in their W-2 preparation costs to cover gathering that information and reporting it” (*Ibid.*).

Fourth, due to the Individual Shared Responsibility mandate, the vast majority of small businesses, essentially those run by individuals who are self-employed (Olafson, 2013), are in fact affected by the new law. “The shared responsibility payment is paid to the Internal Revenue Service as part of an individual’s tax return, and is assessed and collected in the same manner as tax penalties” (Lemper, 2013, p. 798). As indicated above, this amounts to over 22 million establishments, many of which may have to obtain professional help, not with calculating FTEs, but with deciphering possible penalties and credits under the law, i.e., compliance associated with the Individual Shared Responsibility aspects of Obamacare. As observed by Neiburger (2011):

Those who cobbled together this massive approach to extending insurance to most Americans included measures to coerce compliance by individuals and large groups of employers. The reporting requirements are already unpopular, years ahead of their becoming effective. The new laws will require the U.S. Department of Health and Human Services to



promulgate intricate guidelines on what has to be reported and how penalties will be assessed. Administering and monitoring compliance will, unfortunately, absorb both public and private dollars adding to the associated expenses of what, already, is the world's most expensive health care system. (p. 74)

Indeed, because the authors of the ACA tied the law to the tax code to be enforced by the Internal Revenue Service (IRS) (Hines, Kreuze, & Langsam, 2011), it could be argued that anyone who files a tax return or consumes health care (and pays for it), is impacted in some way by Obamacare. To minimize this to a small percentage of businesses or individuals, such as three percent of Americans who purchase health insurance plans on the individual market (Lizza, 2013), is to put forward an indefensible argument.

## CONCLUSION

Even before the Affordable Care Act, health care cost have been among the top issues of concern among small business owners for over two decades (Dennis, 2013). However, findings from this early research effort in the discipline(s) of small business and entrepreneurship suggest that Obamacare may impose significant additional burdens on the backs of small businesses and the self-employed—as well as all citizens—since the economy has yet to completely recover. The implementation has not only been a (Ferenstein, 2013; "Health insurance exchanges: An update from the administration," 2013; Howell, 2013; Roy, 2013a; Straud, 2013), it has been imposed at a less than optimal time. "It's an economic truism that businesses will respond to the incentives that the government provides. That principle is playing out right now in the jobs market, as small businesses adjust to the incentives created by the Patient Protection and Affordable Care Act (PPACA), also known as Obamacare, to cut employment and worker hours" (Shane, 2013).

According to Amato & Schreiber (2013), the Affordable Care Act "has three provisions of particular significance to small businesses. Those provisions are the small business health care credit, the shared responsibility penalty for large employers, and the health care exchanges." However, as submitted herein, besides individual citizens at large, nonemployers are impacted, too. These nonemployers are also part of the fabric of the entrepreneurial community at large, and the impact of Obamacare on the entirety of this community should not be underestimated. An Obamacare-friendly article (Matusiak, 2013) on the U.S. Small Business Administration website (to add context, SBA leadership positions are appointed by the Office of the President) entitled "*Five Ways the Affordable Care Act Helps America's Small Businesses*," lists SHOP Marketplaces, Reducing Administrative Complexity, New Tax Credits: Improved Risk Pooling, and Workplace Wellness.

Given delays (including the one year SHOP Marketplace delay for small businesses with under 50 FTE employees), sticker shock over premium pricing and deductibles, security and privacy threats, the complexities, costs and time-suck entailed in compliance, and the

enormously expensive health care system that already exists in the United States it is hard to imagine how the implementation of a government-designed health care system will result in either an economically healthy or a happily-ever-after ending of any kind. Small businesses must nevertheless do the best that they can to adapt and hopefully survive. For entrepreneurs, it will not be easy to make sometimes gut-wrenching choices that might include cutting people's hours, not hiring or (typically worse) firing, raising prices, or not investing in marketing, equipment, facilities, professional development, training, or other areas that may support growth.

Contrary to "why so much focus on so few?" arguments, healthcare impacts everyone. As such, opportunities for future research are abundant. Except as follows, this present paper has not included coverage of the burgeoning issues on the supply-side of health care delivery, including networks that omit major hospitals, doctors, and other forms of access, or shortages in general. Additional suggestions for further research include possibilities for self-insured options that small businesses might pursue, studies of professional services firms' business volume in connection with dispensing Obamacare-related help to clients, studies of time and effort spent on compliance issues by small (and larger) businesses, and forward looking research that might suggest better ways of delivering healthcare for less (some of which already exist but are in their infancy, such as telemedicine, home health care, drop-in care centers, robo-medicine, access via crossing international boundaries, and cutting-edge therapeutic interventions with greater efficacy in either prevention or treatment).

## REFERENCES

- Amato, N., & Schreiber, S. P. (2013, January). Small businesses struggle to navigate provisions of the health care law: Owners wait for exchanges, fear getting hit by penalties. *Journal of Accountancy*.
- Banjo, S. (2013, November 17). Wal-Mart says insurance costs may hurt customer spending. Retrieved November 17, 2013, from <http://finance.yahoo.com/news/wal-mart-says-insurance-costs-200300759.html>
- Barrineau, J., & Dastagir, A. E. (2013, November 15). Breaking down Obamacare's cancellation 'fix'. Retrieved 11/18/2013, from <http://www.usatoday.com/story/news/politics/2013/11/14/what-you-need-to-know-obamacare/3545511/>
- Boot, M. (2010). ObamaCare and American power. *The Wall Street Journal*. Retrieved October 31, 2013, from <http://online.wsj.com/news/articles/SB10001424052748703312504575141744210163602>
- Chumley, C. K. (2013, October 11). Republicans demand HHS answer for Obamacare website glitches. Retrieved November 17, 2013, from <http://www.washingtontimes.com/news/2013/oct/11/republicans-demand-hhs-answer-obamacare-website-gl/>
- Coombs, B. (2013, April 15). For small business, learning Obamacare math. Retrieved September 19, 2013, from <http://www.cnbc.com/id/100641995>
- Creswell, J. W. (1994). *Research design: Qualitative & quantitative approaches*. Thousand Oaks, CA: Sage Publications.
- Dennis, W. J., Jr. (2013, October). Small business's introduction to the affordable care act part 1. Retrieved 11/18/2013, from [www.nfib.com/research-foundation/studies/aca-2013?utm\\_campaign=ACAStudy&utm\\_source=Research&utm\\_medium=PDF&utm\\_content=acareport](http://www.nfib.com/research-foundation/studies/aca-2013?utm_campaign=ACAStudy&utm_source=Research&utm_medium=PDF&utm_content=acareport)
- Faal, S. (2013, October 23). Obamacare "Death Spiral" warned could collapse global economy by February. Retrieved October 29, 2013, from <http://www.eutimes.net/2013/10/obamacare-death-spiral-warned-could-collapse-global-economy-by-february/>

- Ferenstein, G. (2013, October 20). Obamacare's rollout is a disaster that didn't have to happen. Retrieved 11/4/2013, from <http://www.thedailybeast.com/articles/2013/10/20/obamacare-s-rollout-is-a-disaster-that-didn-t-have-to-happen.html>
- Fiske, J. (1994). Audiencing: Cultural practice and cultural studies. In N. K. Denzin & Y. S. Lincoln (Eds.), *Handbook of qualitative research* (pp. 189-198). Thousand Oaks, CA: Sage Publications.
- Frequently Asked Questions about small business. (2012, September). Retrieved September 25, 2013, from <http://www.sba.gov/advocacy/7495/29581>
- Full-time equivalent employee calculator for employer shared responsibility. (2013). Retrieved September 26, 2013, from <http://business.usa.gov/full-time-employee-calculator>
- Fund, J. (2013, November 11). The truth about navigators Retrieved November 18, 2013, from <http://www.nationalreview.com/article/363699/truth-about-navigators-john-fund>
- Graham, J. (2013, September 25). ObamaCare employer mandate: A list of cuts to work hours, jobs. Retrieved September 26, 2013, from <http://news.investors.com/politics-obamacare/092513-669013-obamacare-employer-mandate-a-list-of-cuts-to-work-hours-jobs.htm>
- Gruber, J. (2012). Program on Health Care. *National Bureau of Economic Research (NBER) Reporter*. Retrieved November 10, 2013, from <http://www.nber.org/reporter/2012number2/2012no2.pdf>
- Health Care And Education Reconciliation Act, Public Law 111 - 152 (H.R. 4872) C.F.R. (2010).
- Health insurance exchanges: An update from the administration. (2013, November 6). *United States Senate Committee on Finance*. Retrieved November 9, 2013, from <http://www.finance.senate.gov/hearings/hearing/?id=3dd91089-5056-a032-5290-f158359b9247>
- Health insurance marketplace: November enrollment report. (2013). Retrieved November 18, 2013, from [http://aspe.hhs.gov/health/reports/2013/marketplaceenrollment/rpt\\_enrollment.pdf](http://aspe.hhs.gov/health/reports/2013/marketplaceenrollment/rpt_enrollment.pdf)
- Hines, C., Kreuze, J., & Langsam, S. (2011). The new healthcare tax credit for small employers. *CPA Journal*, 81(3), 46-49.
- Hodder, I. (1994). The interpretation of documents and material culture. In N. K. Denzin & Y. S. Lincoln (Eds.), *Handbook of qualitative research* (pp. 393-402). Thousand Oaks, CA: Sage Publications.
- Howell, J., Tom. (2013, October 30). Obamacare not for me, HHS head Kathleen Sebelius says. Retrieved November 4, 2013, from <http://www.washingtontimes.com/news/2013/oct/30/sebelius-rejects-enrolling-obamacare-exchanges/?page=all#pagebreak>
- Howerton, J. (2013, November 14). Second undercover video catches more Obamacare 'Navigators' advising applicants to lie for lower premiums. Retrieved November 18, 2013, from <http://www.theblaze.com/stories/2013/11/14/second-undercover-video-catches-more-obamacare-navigators-advising-applicants-to-lie-about-their-income/>
- Hu, E. (2013, November 1). HealthCare.gov's rocky first month leaves plenty of questions. Retrieved November 4, 2013, from <http://www.npr.org/blogs/alltechconsidered/2013/11/01/242375608/healthcare-govs-rocky-first-month-leaves-plenty-of-questions>
- Jacobe, D. (2013). Half of U.S. small businesses think health law bad for them. Retrieved September 23, 2013, from <http://www.gallup.com/poll/162386/half-small-businesses-think-health-law-bad.aspx>
- Katz, J. A. (2012, January 22). Core publications in entrepreneurship and related fields: A guide to getting published. Version 5.6. Retrieved October 12, 2013, from <http://www.slu.edu/x17970.xml>
- Klein, K. E. (2012). What Obamacare means for small employers in 2013. Retrieved September 25, 2013, from <http://www.businessweek.com/articles/2012-10-04/what-obamacare-means-for-small-employers-in-2013>
- Kliff, S. (2013, December 2). Can HealthCare.gov actually handle 50,000 users at a time? Retrieved December 8, 2013, from [http://www.washingtonpost.com/blogs/wonkblog/wp/2013/12/02/can-healthcare-gov-actually-handle-50000-users-at-a-time/?wprss=rss\\_ezra-klein](http://www.washingtonpost.com/blogs/wonkblog/wp/2013/12/02/can-healthcare-gov-actually-handle-50000-users-at-a-time/?wprss=rss_ezra-klein)
- Kobe, K. (2012, January). Small business GDP: Update 2002-2010. Retrieved September 25, 2013, from <http://www.sba.gov/advocacy/7540/42371>
- Lahm, R. J., Jr. (2013, October 17-19). *Obamacare and small business: "Wait and see"*. Paper presented at the Intellectualbase International Consortium (IIC), Atlanta, GA.

- Lawson, L., & Nelson, J. Controlled and Affiliated Service Groups. Retrieved September 25, 2013, from <http://www.irs.gov/pub/irs-tege/epchd704.pdf>
- Lemper, T. A. (2013). The supreme struggle: 'Obamacare' and the new limits of federal regulation. *Business Horizons*, 56, 797-805.
- Ligon, J. L. (2010, April 27). Obamacare: Impact on businesses. Retrieved September 19, 2013, from <http://www.heritage.org/research/reports/2010/04/obamacare-impact-on-businesses>
- Lizza, R. (2013, October 30). Obamacare's Three Per Cent. Retrieved November 11, 2013, from <http://www.newyorker.com/online/blogs/newsdesk/2013/10/obamacares-three-per-cent.html?mobify=0>
- Matusiak, A. (2013, September 10). Five ways the Affordable Care Act helps America's small businesses. Retrieved September 19, 2013, from <http://www.sba.gov/community/blogs/five-ways-affordable-care-act-helps-america%E2%80%99s-small-businesses>
- Mrkvicka, N., Held, J., Stich, J., & Kolsrud, K. (2013, May 13). 2013 employer-sponsored health care: ACA's impact. Retrieved December 9, 2013, from <http://www.ifebp.org/pdf/research/2103ACAImpactSurvey.pdf>
- Myers, L. (2013, November 16). Insurers, state officials say cancellation of health care policies just as they predicted. Retrieved November 18, 2013, from [http://investigations.nbcnews.com/\\_news/2013/11/15/21482622-insurers-state-officials-say-cancellation-of-health-care-policies-just-as-they-predicted?lite](http://investigations.nbcnews.com/_news/2013/11/15/21482622-insurers-state-officials-say-cancellation-of-health-care-policies-just-as-they-predicted?lite)
- National Federation of Independent Business v. Sebelius, Slip Opinion, No. 11-393 (United States Supreme Court, 2012).
- Neiburger, B. A. (2011). Health care reform's impact on small businesses and individuals. *NAELA Journal*, 7(1), 61-74.
- Obama, B. H. (2010, March 25). Remarks by the President on Health Insurance Reform, University of Iowa Field House, Iowa City, Iowa. Retrieved November 26, 2013, from <http://www.whitehouse.gov/the-press-office/remarks-president-health-insurance-reform-university-iowa-field-house-iowa-city-iow>
- Obamacare 'horror' story turns out to be Obamacare success story. (2013, November 2). Retrieved November 11, 2013, from <http://www.electablog.com/2013/11/obamacare-horror-story-turns-out-to-be-obamacare-success-story.html>
- Office of the Legislative Counsel Compilation of Patient Protection And Affordable Care Act. (2010). Retrieved September 24, 2013, from <http://housedocs.house.gov/energycommerce/ppacacon.pdf>
- Olafson, M. K. (2013). Self employed? What you need to know about Individual Shared Responsibility starting in January 2014. Retrieved September 19, 2013, from <http://www.sba.gov/community/blogs/self-employed-what-you-need-know-about-individual-shared-responsibility-starting-january-2014>
- Pagliery, J. (2013). The overblown Obamacare myth about small business. Retrieved September 19, 2013, from <http://money.cnn.com/2013/05/21/smallbusiness/obamacare/index.html>
- Patient Protection and Affordable Care Act, Public Law 111 - 148 (H.R. 3590) C.F.R. (2010).
- Pearson, M. (2013, November 4). Obamacare website goes dark for nightly fix-it work. Retrieved November 4, 2013, from [http://www.cnn.com/2013/11/04/politics/obamacare/index.html?hpt=hp\\_t2](http://www.cnn.com/2013/11/04/politics/obamacare/index.html?hpt=hp_t2)
- Pelosi, N. (2010). Pass the Bill to find out what is in it. Retrieved September 23, 2013, from <http://www.youtube.com/watch?v=QV7dDSgbaQ0>
- Pfeiffer, E. (2013, December 4). Harry Reid exempts some of his Senate staff from Obamacare exchanges. Retrieved December 7, 2013, from <http://news.yahoo.com/harry-reid-exempts-some-of-his-senate-staff-from-obamacare-exchanges-192925037.html>
- PPACA implementation failures: Answers from HHS. (2013, October 30). Retrieved December 9, 2013, from <https://energycommerce.house.gov/hearing/ppaca-implementation-failures-answers-hhs#video>
- Radnofsky, L., Weaver, C., & Needleman, S.E. (2013, 9/27). New hitch hits health rollout, *Wall Street Journal*, p. A1. <http://online.wsj.com/article/SB10001424052702303796404579099310270573146.html#project%3DEXCHANGES2013%26articleTabs%3Darticle>
- Rinaldi, M. (2013). Obamacare and the shutdown: Rightful stand or neoconfederate obstruction? Retrieved October 30, 2013, from <http://www.theguardian.com/commentisfree/2013/oct/19/obamacare-shutdown-headtohead>
- Rogers, K. (2012, March 6). Small business doesn't want a one-night-stand president. Retrieved September 18, 2013, from <http://smallbusiness.foxbusiness.com/legal-hr/2012/03/06/small-business-doesnt-want-one-night-stand-president/>

- Rose, C. (2013, December 1). Amazon's Jeff Bezos looks to the future. Retrieved December 8, 2013, from <http://www.cbsnews.com/news/amazons-jeff-bezos-looks-to-the-future/>
- Roy, A. (2013a, October 31). Obama officials in 2010: 93 million Americans will be unable to keep their health plans under Obamacare. Retrieved November 26, 2013, from <http://www.forbes.com/sites/theapothecary/2013/10/31/obama-officials-in-2010-93-million-americans-will-be-unable-to-keep-their-health-plans-under-obamacare/>
- Roy, A. (2013b). When it's already broken *National Review*, 65(20), 18-22.
- Rules and Regulations. (2010, June 17). *Federal Register*. Retrieved November 10, 2013, from <http://www.gpo.gov/fdsys/pkg/FR-2010-06-17/pdf/2010-14488.pdf>
- Schlussel, D. (2013, December 2). Healthcare.flub v. Black Friday & Cyber Monday: Walmart & Amazon show up Obama. Retrieved December 8, 2013, from <http://www.debbieschlussel.com/67630/healthcare-flub-v-black-friday-cyber-monday-walmart-amazon-show-up-obama/>
- Shane, S. (2013, September 12). Obamacare already shrinking small-business job growth. Retrieved September 19, 2013, from <http://www.entrepreneur.com/article/228335>
- Siegel Bernard, T. (2013, September 27). A guide to the new exchanges for health insurance. Retrieved September 29, 2013, from [http://www.nytimes.com/2013/09/28/your-money/health-insurance/a-guide-to-the-new-health-insurance-exchanges.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2013/09/28/your-money/health-insurance/a-guide-to-the-new-health-insurance-exchanges.html?pagewanted=all&_r=0)
- The small business economy. (2012). Retrieved September 25, 2013, from [http://www.sba.gov/sites/default/files/Small\\_Business\\_Economy\\_2012.pdf](http://www.sba.gov/sites/default/files/Small_Business_Economy_2012.pdf)
- Small business health care tax credit questions and answers: Determining FTEs and average annual wages. (2013, August 23). Retrieved September 28, 2013, from <http://www.irs.gov/uac/Small-Business-Health-Care-Tax-Credit-Questions-and-Answers:-Determining-FTEs-and-Average-Annual-Wages>
- Straud, B. (2013, July 30). Small businesses share real-world Obamacare effects with Congress. Retrieved September 19, 2013, from <http://pjmedia.com/blog/small-businesses-share-real-world-obamacare-effects-with-congress/>
- Tanner, M. D. (2013, October 30). Beyond the Obamacare website fiasco. Retrieved November 11, 2013, from <http://www.cato.org/publications/commentary/beyond-obamacare-website-fiasco>
- Taulli, T. (2013, November 29). Small business: What's the impact of the Obamacare delay? Retrieved December 7, 2013, from <http://www.forbes.com/sites/tomtaulli/2013/11/29/entrepreneurs-whats-the-impact-of-the-obamacare-delay/>
- U.S. Census Bureau nonemployer statistics. (2013, August 12). Retrieved September 27, 2013, from <http://www.census.gov/econ/nonemployer/>
- U.S. Chamber of Commerce Q2 2013 small business survey. (2013).
- Wallace, G. (2013, October 31). Google engineers tapped to revive HealthCare.gov. Retrieved November 4, 2013, from <http://money.cnn.com/2013/10/31/technology/enterprise/obamacare-site-tech-surge/>
- What does Marketplace health insurance cover? (2013). Retrieved September 29, 2013, from <https://www.healthcare.gov/what-does-marketplace-health-insurance-cover/>
- Whelan, D. (2013, September 24). Trader Joe's, Home Depot and the unresolved fairness issue inside ObamaCare. Retrieved September 28, 2013, from <http://www.forbes.com/sites/davidwhelan/2013/09/24/trader-joes-home-depot-and-the-unresolved-fairness-issue-inside-obamacare/>
- Wieczner, J. (2013, August 22). Why your boss is dumping your wife: UPS joins growing list of companies kicking spouses off health insurance. Retrieved September 28, 2013, from <http://www.marketwatch.com/story/why-your-boss-is-dumping-your-wife-2013-02-22>
- Young, J. (2013, October 18). Obamacare website failure threatens health coverage for millions of Americans. Retrieved November 3, 2013, from [http://www.huffingtonpost.com/2013/10/18/obamacare-train-wreck\\_n\\_4118041.html](http://www.huffingtonpost.com/2013/10/18/obamacare-train-wreck_n_4118041.html)



# ACTIVITY BASED COSTING IN SERVICES INDUSTRY: A CONCEPTUAL FRAMEWORK FOR ENTREPRENEURS

Osman Kursat Onat, Mehmet Akif Ersoy University  
Ismet Anitsal, Tennessee Tech University  
M. Meral Anitsal, Tennessee Tech University

## ABSTRACT

*Services marketing is a key operation in businesses' economic activities and is becoming more important in both developed and developing economies. Since the service industry is a strategic sector for gross domestic product, cost and pricing concepts must be investigated thoroughly. True cost and resource management are fundamental to successful services marketing operations in entrepreneurial activities. Therefore, costing has also been crucial for successful execution of service processes and profitability and sustainability. In the last several decades, many methods have been discussed about and applied to true costing and efficient use of resources. Traditional approaches have included full costing that focuses on units produced, while contemporary approaches include just-in-time (JIT), throughput costing, theory of constraints and activity based costing that focused more on value, waste reduction and activities. In this study, activity based costing (ABC) is investigated in services marketing context, and a conceptual framework of ABC is illustrated for entrepreneurs to use in the service marketing industry.*

**Keywords:** Activity Based Costing, Services Marketing, Entrepreneurship

## INTRODUCTION

In highly competitive environments, businesses struggle under cost pressure and profit margin squeezes. As a result of intense competition, businesses must effectively manage costs and competitively price their products and services. Therefore, cost measurement and cost management methods are becoming more important aspects of pricing and overall marketing decisions.

Doing business can be defined as the art of getting most profit with scarce resources available. Companies may move in two possible directions: profit or cost. In international business, all prices are determined globally, and local or global competitors cannot set prices freely. Therefore, profit is limited because of pricing constraints. As a result, many businesses often prefer to focus on managing their costs more efficiently.

Cost management is the process of managing all resources efficiently. It is a more complex and complete activity than costing products and services alone. Cost management not only involves determining costs, but also requires making decisions about the whole process,

cost allocation, pricing, and resource management. An important issue in cost management is selecting the right costing tool for the industry, company, and product or service. Cost management methods can be classified as either traditional, focusing on volume and labor, or contemporary, focusing on efficient and suitable cost drivers.

Traditional costing methods often fail to adequately deal with overhead costs. Most of these methods directly allocate overhead costs, often based on volume or direct labor, and do not relate them with activities. This approach leads to incorrect allocations and disrupted costs (Baines, 1992). Traditional cost methods also fail by emphasizing high volume activities; consequently, highly important but less volume-generating activities incur fewer costs.

In contrast, contemporary costing methods focus more on value and value-adding activities than on batch sizes and product units. Contemporary methods appear to be in line with value that goes beyond price, whereas service options and delivery times become more important in service industries. In such situations, activity based approaches seem to be more useful than unit based methods. Just-in-time (JIT), activity based costing (ABC), theory of constraints, and target costing are contemporary costing methods that have gained recognition during the last several decades. These contemporary costing methods differ from traditional ones by emphasizing function and value, reducing miscalculations by better classifying activities, and reducing bottlenecks in production stages. ABC deserves special attention as it is based on classification and allocation of costs via cost drivers.

In this paper, two emerging concepts of business—services marketing and activity based costing—and how they can be integrated are discussed to help entrepreneurial businesses in service industries. This paper's main goal is to develop a conceptual framework that is highly applicable to those businesses' entrepreneurial marketing activities. The main elements of ABC and services marketing are also described, and the conceptual framework is explained.

## **ACTIVITY BASED COSTING**

### **DEFINITION OF ACTIVITY BASED COSTING**

Johnson and Kaplan (1987) first attracted attention to the need for contemporary, activity focused cost management techniques with their paper entitled "Relevance Lost." They stated that traditional costing methods cause miscalculations in product pricing by giving more importance to production volume than to activities. To fill such gaps and prevent incorrect costing and pricing, Johnson and Kaplan developed and introduced an activity based costing method.

Costing is one of the most important concepts in business activities. True and efficient costing provides an essential base for true pricing and improved profit margins. Incorrect costing practices may cause businesses to invest in the wrong product portfolio and the overall business strategy to fail.

The activity based costing method differs from traditional costing methods, which measure costs through cost drivers and costing not only products, but also activities (Baines, 1992). Activity based costing (ABC) focuses on the idea that activities create costs, while products use activities to gain value added. ABC first identifies the major activities creating overhead costs, then groups activities having the same cost drivers into cost pools, and finally



assigns total overhead costs to each product or service by calculating each cost pool's absorption rate (Ahmed et al., 2011, p. 994).

## CORE CONCEPTS OF ACTIVITY BASED COSTING

Compton (1996) described ABC's eight key elements, which are listed in Table 1. Some of the key elements, such as resources, are fundamental. Others are specific to activity based costing, such as the first four that are ingredients of the last four concepts. In determining a service's indirect costs, each activity is examined in terms of the resources that activity involves so that indirect costs are based on the quantities and types of activities required to perform a service or produce a good. Furthermore, ABC involves allocating costs via cost drivers. Although cost drivers are similar to traditional costing, being designated to specific activities make them specific to ABC.

<b>Number</b>	<b>Element</b>	<b>Definition</b>
1	Resources	Economic elements used to perform activities, such as management costs, facilities, support, etc.
2	Activity	Processes or procedures used to do work
3	Activity Center	A cluster of related activities
4	Resource Drivers	Factors used to allocate resources or pools of costs to activities
5	Activity Cost Pool	The total cost assigned to an activity
6	Activity Driver	A factor used to assign cost from an activity center to other activity cost pools or cost objects
7	Cost Element	The amount paid for a resource assigned to an activity
8	Cost Object	The ultimate goal for performing an activity; in ABC, it represents the final cost assigned to a product or service.

Source: Compton, T. R. (1996).

Key elements of ABC can be counted as elements about resources, about costs, and about activities that produce goods and services. Resources represent assets used to perform production activities. Determining and classifying activities are the most discriminating sides of ABC. Activity is the start and end point of the costing process. Product/service costs should be noted according to the number of activities performed and resources used for them. Cost pool is also a new ABC concept that summarizes all the activities-related costs. Cost drivers are metrics used in allocating costs to cost objects. Cost object is also a general concept including both products and/or services.

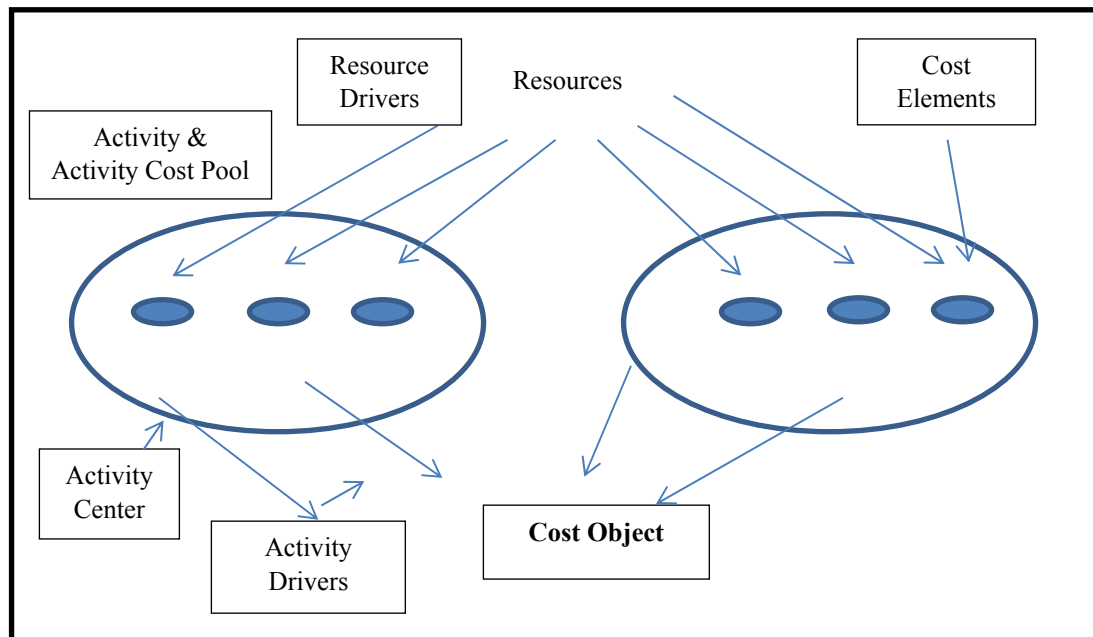
## COSTING PROCESS IN ABC

The activity based costing process (Figure 1) involves three phases. The first phase involves determining activities, including classifying and entitling those involved in producing a good or service (Oker, 2003).

The second phase of activity based costing is determining cost drivers, which are metrics used for allocating costs to goods or services. Cost drivers are based on the activities and product/services relationship and should be designed to most suitably allocate cost according to the structure of activities. Cost drivers must be determined by both how activities use/consume resources and whether performing a specific activity is essential (Oker, 2003).

The third phase in the activity based costing process is cost allocation, which is based on the rate of products/services to consume activities. The level of resources is determined via cost drivers (Oker, 2003).

**Figure 1 - ACTIVITY BASED COSTING PROCESS**



Source: Compton, T. R. (1996)

In traditional costing methods (especially in full costing), one of the most important factors is allocating overhead costs. Misallocations may cause relatively incorrect costing and pricing. The fundamental assumption of ABC is that cost objects (goods or services) are results of activities that consume resources therefore; activities direct the cost management process. On the other hand, batch production is a volume-based production methodology in which unit sizes and volumes are more important. Batch-focused costing methods fail in allocating overhead costs because producing more units considered loading more overhead.

In the ABC process, units going through more activities get more overhead costs. Consequently, miscalculations are avoided. Another important factor of ABC is allocating costs via activity drivers that provide the most suitable cost allocation to product/service characteristics because drivers dissimilar to production characteristics may cause miscalculations. For example, direct labor hours are used to allocate most of overhead costs in the traditional costing method, but it may cause incorrect costing because of using the same metric for every type of calculation. Those issues are solved in ABC by determining activity drivers similar to characteristics of activities.

## **PROS AND CONS OF ABC**

Every costing method may naturally have some advantages and disadvantages. Therefore, none of the costing methods can be considered excellent for all types of business needs. Those methods having more advantages than disadvantages and being more convenient for most industries are widely accepted and often used among businesses. Activity based costing (ABC) may be an advantageous cost management method, especially for entrepreneurs in services industries. According to the literature, businesses give up traditional costing methods for the following reasons: not providing non-financial information, generating inaccurate cost information, failing to allocate overhead costs, and constructing barriers to improvements (Gunasekaran, 1999). One common drawback among these reasons is that traditional costing systems do not seem to provide a good infrastructure for marketers, especially entrepreneurial marketers in service industries, to develop and implement effective creative marketing strategies (e.g., pricing strategy, promotion strategy, brand strategy) and tactics.

Major advantages of adopting and implementing ABC are summarized below (Cohen, 2004; Cardos and Pete, 2011; Gunasekaran, 1999; Agbor and Jackson, 2012, Mishra and Bal, 2012; Bartolacci, 2004; Chrongruskut, 2002, Stapleton, 2004):

- Improving product cost and helping decision making to enhance performance measurements,
- Providing more accurate cost information,
- Improving cost reduction,
- Processing more realistic view by detecting and eliminating waste,
- Identifying non-value adding activities
- Using activity-based performance measures,
- Providing accurate cost information,
- Targeting cost reduction,
- Providing measures for performance measurement,
- Assisting management in decision making,
- Providing a detailed framework for analyzing cost variances, and
- Applicability to cost objects other than products.

Major disadvantages of utilizing ABC are the following (Cardos and Pete, 2011; Gunasekaran, 1999; Agbor and Jackson, 2012; Mishra and Bal, 2012; Bartolacci, 2004, Stapleton, 2004):

- Difficulties in implementation process,
- Resistance from both management and employees to change,
- System implementation's requirement of detailed technical skills and equipment,
- Uncertainty of implementation costs,
- Activities too difficult to identify,
- Difficulties in data collection,
- System more suitable to high-overhead companies, and
- High system investments.

Many researchers have questioned the reasons for implementing activity based costing. Because ABC has been implemented in all types of industries, practitioners may have different reasons for implementing this cost management method. Based on a review of industry-based research, reasons for using ABC can be classified under its advantages, the disadvantages of traditional systems, and the business environment's structure.

ABC's advantages include the following: an effective performance-improvement tool, an aid in strategic decision making, and transfer pricing (Garg and Rafiq, 2002); usefulness of accounting information, organizational support, internal measures of performance (Maelah and Ibrahim, 2007); fostering, motivating and supporting management information systems (Carmo and Padovani, 2012); generating more useful cost information, assisting making various decisions (Nassar et al., 2011); possibility of achieving more accurate costing information (Doyle et al., 2008), providing insight into cost causation, helping cost reduction and control, provision of more accurate information for pricing and profitability analysis (Basteki and Ramadan, 1998).

Deficiencies of existing systems in providing useful information to management represent other reasons to implement ABC, which stem from the disadvantages of traditional systems to updating cost management systems, existing systems (Al-Omiri, 2012).

Other researchers have also identified multiple reasons related to business structure to move to ABC, including non-accounting ownership, higher information technology, growing cost variety, and inability of traditional costing system to provide relevant information in new and more complex business environments (Fadzil and Rababah, 2012), cultural dimensions of outcome orientation, tight versus loose control (Baird et. al., 2004), beliefs of traditional cost allocation being deficient in global competitive business environment (Salawu and Ayoola, 2012).

## **SERVICES MARKETING**

Services are economic activities that are provided to people or possessions of those people by another party. In other words, services are performances. Goods can be used in those performances, but the title of those goods do not usually transfer from the service provider to the customer. Services are tangible and intangible actions performed on people's bodies or possessions; such services include rental, temporary use of an object, or the labor or expertise of personnel. Customers pay for desired outcomes, experiences and solutions, not necessarily ownership of objects such as computers, dining sets, or lawn furniture (Lovelock and

Gummesson, 2004). In the non-ownership approach, customers may prefer to purchase the temporary right to use an object such as with the rental of a car, furniture or construction equipment. Customers may also want to acquire space in a building or a vehicle. A seat in an aircraft or space in an apartment may be in this category. Customers may also rent other people's expertise by, for example, getting a haircut, management consultation, or higher education. Another category of rental is access to shared physical environments, such as theme parks or toll roads. Finally, customers may want to use systems or networks, such as internet access, banking, and utilities. In all of these cases, customers do not want to invest in the high fixed costs of building such systems themselves.

Service actions are tangible or intangible. In people processing services, tangible actions are performed on people's bodies, such as in health care and beauty salons. However, possession processing services involve tangible actions performed on people's possessions, such as house remodeling, pet grooming, and dry cleaning. Tangible actions are performed on people's minds (mental stimulus processing such as education, religious services and concerts) or people's possessions (information processing services such as banking and accounting). Customers are usually physically present for people processing services and contribute to the production of the service, hence directly influencing the service provider's employee productivity. Active cooperation from customers is expected in these services compared to possession processing services where customer cooperation is welcomed but not necessarily expected.

Regardless of the above-mentioned service categories, the customer, service-provider technology/systems, and employees continuously interact in service industries, unlike in manufactured goods industries. These characteristics required re-evaluating the 4P's of service industries' traditional marketing mix: people, processes, and physical evidence (Zeithaml, Bitner & Gremler, 2006) together with product, price, promotion, and place (Table 2).

<b>Table 2</b>	
<b>7Ps OF SERVICES MARKETING</b>	
<b>Concept</b>	<b>Definition</b>
People	Human resources are key elements in all service marketing activities. Efficient service marketing without the human factor is impossible.
Process	The procedures, mechanism, and flow of activities by which the service is delivered; the service delivery and operating systems
Physical Evidence	The environment in which the service is delivered and where the company and customer interact
Pricing for Services	Pricing depends on usage and limits of services.
Products/Services	This includes products/services created, offered/delivered to customers.
Place for Services	Place of consumption of services signs this term.
Promotion for Services	The methods for promoting services may differ greatly. All channels should be considered in this manner.

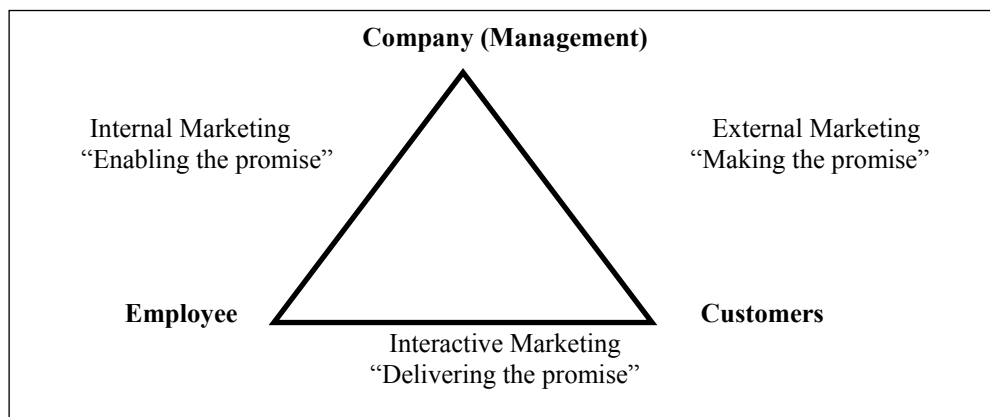
Source: Zeithaml, Bitner and Gremler (2006)

According to the 7P's of services marketing, the services marketing process includes concepts similar to those in the traditional marketing process. Those properties vary according to fundamental characteristics of service as explained below:

*Service marketing is about promises- promises made and promises kept to customers. A strategic framework known as services triangle visually reinforces the importance of people in ability of firms to keep promises and succeed in building relationships. The triangle shows the three interlinked groups that work together to develop, promote and deliver services. These key players are labeled on the points of the triangle: the company; the customers; and the providers. (Zeithaml, Bitner and Gremler, 2006, p. 355-356).*

The services marketing triangle (Figure 2) is an indicator of complex interactions among company, employees, and customers. This complexity of services causes difficulties not only in managing services but also in applying accounting satisfactorily to serve both marketing needs and accounting requirements. Traditional cost accounting approaches work well with services having large proportions of variable or semi-variable costs, such as mental stimulus processing services or services that rent expertise of others. However, if service firms have high fixed costs or complex service offerings, traditional costing methods o or misplace costs of operation. For example, allocating fixed costs of running a hospital emergency room may show that department as very profitable or as a financial loss. The emergency department's overhead can be allocated as the percentage of total floor space, of employee hours, or of patient-contact hours. Which one of the alternatives is a better method from accounting perspective? Which one will give marketing managers a better understanding of how to build and promote the emergency department? ABC costing is a more accurate way to allocate indirect costs for service companies.

**Figure 2 - THE SERVICES MARKETING TRIANGLE**



Source: Zeithaml, Bitner and Gremler, (2006).

## **AN ILLUSTRATION OF ABC COSTING IN A SERVICES CONTEXT**

This part of the current study presents an illustration of using activity based costing in a services marketing context for entrepreneurs. This illustration specifically consists of the integration of ABC with services marketing and the development of a conceptual framework.

Services marketing activity can be divided into hundreds of sub items. This study is not attempting to develop a one-size-fits-all model; instead, the distinct differences among services marketing's sub items should be considered. Thus, this illustration provides a general idea of the services marketing industry. Finding examples of integrating ABC into service activities, especially into entrepreneurial frameworks, is difficult. Nevertheless, one of the main goals of this illustration is to present a definitive framework for entrepreneurs.

### **INTEGRATION OF ACTIVITY BASED COSTING WITH SERVICES MARKETING**

As previously mentioned, services are economic performances done on people or possessions. Integration of ABC with services marketing involves designing and performing ABC in a services marketing context with appropriate cost drivers and cost pools. Individual service activity is a cost object. For example, hair cutting as a core service is an individual service activity, even though a hair dresser may decide to provide an elaborate blow dry as a supplementary service. Classifying service costs and appointing cost drivers are key elements in the integration process.

As explained before, the fundamentals of service marketing have been expanded to the 7P's: people, process, physical evidence, pricing for services, product for services, place for services, and promotion of services. This expansion means that services have different characteristics than products, and different cost classifications, and drivers. Collectively, promotional costs are observed to go one more step than the other P's because of the structure of services marketing. Additionally, no activity can be thought of as being separate from physical place, interaction, facilities, and people. Furthermore, because pricing is generally a process after costing, cost allocation becomes the key requirement for successful revenue management in services.

While classifying costs in this illustration, "product for services" and "pricing for services" were excluded. First, because the conceptual framework focuses solely on explaining costing process, the elements (7P's) related to this costing illustration were chosen. Second, the cost of product/services and pricing results from the costing process. Examples of costs included in services marketing activities are illustrated in Table 3.

Cost Type	Cost Example
Costs of Promotion	Advertising, Personal Sales, Loyalty, Sustainability, Introduction
Costs of Process	Interaction with Customers, Communication, Standard Expenses of Services
Costs of People	Human Resources, Training
Costs of Place	Places where Service Activity Processed
Costs of Physical Evidence	Physical/Interactive Marketplaces

Cost types for services marketing are explained below.

**Costs of Promotion:** These costs include expenses while advertising and introducing services to new/potential customers/users. Expenses/costs of persuading new customers about services and costs of sustaining the services' positive image are considered promotional costs. Other promotional costs include discounts to loyal customers, advertising, personal sales, loyalty, sustainability, and introduction.

**Costs of Process:** These costs include those arising during performance of the service such as communication with people, interaction with customers, and web/mail to ensure flawless flow of service activities. Others are signs and signatures to inform customers about what they need to do to receive the service, such as what to do to park and pay for a car in a garage.

**Costs of People:** These costs include costs of human resources in the services marketing process. Benefits such as health and life insurance as well as wages and salaries are in this category. Training for personnel is also included in this cost.

**Costs of Place:** These costs include those involving service factory and facilities, depreciation costs, and general overhead. Places where service activity is processed such as rent for retail stores, restaurant buildings, and hair salons are also in this cost category.

**Costs of Physical Evidence:** This type of cost is similar to place costs but differs according to the type physical evidence. Performance stage for services marketing provides physical evidence such as service factory design, decoration, lightening fixtures, signage, web design, kiosks. These can be classified as physical and interactive marketplaces. Other examples include overall appearance- and maintenance-related costs, such as landscaping, janitorial expenditures, design of sales receipts, and customer surveys.

Drivers are the next topic of analysis in ABC costing for services. There are two types of drivers: resource drivers and cost drivers. In order to include drivers to analysis, the first step is to collect all of the overhead costs according to activities; and in second step, the costs are allocated to cost pools via cost drivers because the cost pools are determined according to type of services marketing activity. For illustration purposes, cost pools are determined with general names in this study. Classification and specialization have to be performed by businesses in multiple service industries. Table 4 provides a classification of resource drivers, which have similar characteristics among many service industries.



<b>Classification</b>	<b>Activity</b>	<b>Resource Driver</b>
Promotion	Advertising	Repetition per Service Activity
	Personal Selling	Costs of Negotiations until Agreement
	Loyalty	Discounts per Present Customers
	Sustainability	Regular Promotion per Month
	Introduction	Repetition per Service Activity
Process	Interaction with Customers	Time of Dealing until Agreement
	Communication	Minutes per Deal
	Standard Expenses	Number of Dealings per standard expense (General Overhead + Expenses)
People	Human Resources	People per Service Activity (Based on Type)
Place	Where Service Activity Is Processed	Square Feet (Depreciation, etc.)
Physical Evidence	Physical Marketplace	Square Feet (Depreciation, etc.)
	Interactive Marketplace	Number of Dealings per Hosting Cost

In Table 5, examples of cost drivers are listed based on generic service cost pool classification. Cost drivers have characteristics that are determined according to types of activities..

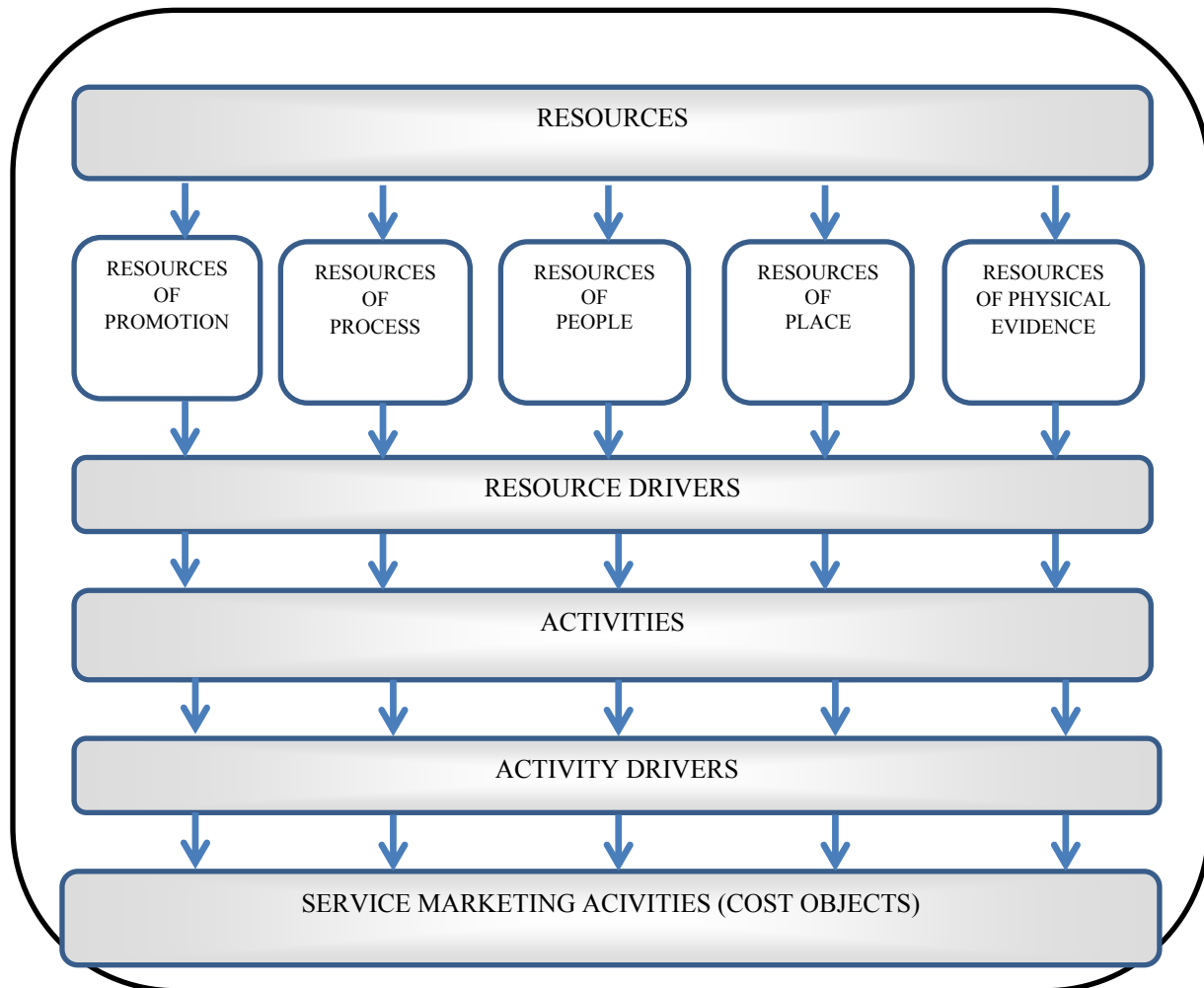
<b>Classification</b>	<b>Cost Driver</b>
Promotion Cost Pool	Repetition per Service Marketing Activity
Process Cost Pool	Minutes per Deal
People Cost Pool	People per Service Activity (According to Type)
Place Cost Pool	Number of Dealings per Place Costs (Depreciation, etc.)
Physical Evidence Cost Pool	Number of Dealings per Place Costs (Depreciation, etc.)
	Number of Dealings per Hosting Costs

A general conception was derived in this manner. The name of cost pools may be changed according to the type of activity. Tables 4 and 5 give a general idea of determining resource and cost drivers and cost pools

## **DEVELOPMENT OF CONCEPTUAL FRAMEWORK**

This conceptual framework is generic and should be customized according to an entrepreneur's specific industry. Every activity consumes different resources related to the industry, product/service types and business environment. In this manner, intangible resources are especially important in service marketing activities. Figure 3 illustrates the entire ABC process in services marketing. Customer participation and co-production are not discussed in this paper; their accounting implications are a topic for another paper.

**Figure 3 - ILLUSTRATION OF ACTIVITY BASED COSTING PROCESS IN SERVICES MARKETING**



## SAMPLE ILLUSTRATION ABOUT INSURANCE COMPANY

<b>Table 6</b>					
<b>EXPENSES AND RESOURCE DRIVERS IN AN INSURANCE COMPANY</b>					
<b>Classification</b>	<b>Activity</b>	<b>Type</b>	<b>Amount of Expense</b>	<b>Resource Drivers Amount</b>	<b>Resource Drivers</b>
<b>Promotion</b>	Advertising	TV Channels Newspapers Websites	\$100,000 per month \$80,000 per month \$60,000 per month	5,000 times 5,000 times 10,000 times	Frequency per Service Marketing Activity
	Loyalty	Discounts for Health Contracts Discounts for Life Contracts Discounts for Vehicle Contracts Discounts for Agricultural Contracts	\$ 180,000 \$ 225,000 \$ 170,000 \$ 65,000	45,000 cont. 30,000 cont. 10,000 cont. 15,000 cont.	Discounts per Existing Customer Contract Renewals
<b>Process</b>	Communication	Health Ins. Life Ins. Vehicle Ins. Agricultural Ins.	\$ 10,000	7,500 min. 4,500 min. 8,000 min. 5,000 min.	Time of Dealing until Closing Sales
	Standard Maintenance Expenses	Electricity Water Heating Other	\$ 5,000 \$ 3,000 \$ 1,500 \$ 500	25,000 Deals	Number of Dealings (New + Existing)
<b>People</b>	Human Resources	Phone Web Advertising Planning	\$ 50,000	5 people 5 people 5 people 5 people	People per Service Activity
<b>Place</b>	Places where Service Activity Is Performed	Phone Web Advertising Planning	\$ 1,000 per month	500 sq. ft 800 sq. ft 700 sq. ft 500 sq. ft	Sq. Ft
<b>Physical Evidence</b>	Interactive Marketplace	Deals	\$ 4,050 per month	13,500 Deals/Web	Number of Deals per Hosting Cost

In this section, a hypothetical illustration of an insurance company's services marketing activity is provided. On the basis of randomly selected figures information about services marketing activity was defined.

XYZ Insurance LLC offers many types of insurance to individuals and businesses. The major types of insurance the company sells are health, life, vehicle and agricultural. The company's services marketing activity is performed through agents, phones and web channels. The company supports its agents' services marketing activities only by providing documents and

brochures. Other costs of running the day-to-day business are the agents' responsibility. Information about the costing process is provided below; along with details of the company's headquarter costing process.

Let's assume that the company completes 25,000 new sales deals in a particular month. Moreover, 100,000 existing customers renewed their contracts after the company completed a \$240,000 advertising and \$640,000 promotion campaign in that period. All services marketing activities are performed in 2500 sq. ft area with 20 people via phone and web.

Identified in Table 7, activities and cost pools are determined according to the industry type. Therefore, entrepreneurs in any industry should spend time identifying specific activities and cost pools. For illustration purposes, activities performed for promotion and deal formation for the insurance company are discussed in more detail.

<b>Table 7</b>		
<b>ACTIVITIES AND COST POOLS</b>		
<b>Activities</b>	<b>Cost Pools</b>	<b>Activity Drivers</b>
<b>Promotion- Basic (A1)</b>	Advertising	Number of Total Deals (New + Existing)
<b>Promotion- Loyalty (A2)</b>	Loyalty	Number of Existing Deal Renewals
<b>Sales closing (A3)</b>	Communication Standard Maintenance Expenses Human Resources Place	Number of Total Deals (New + Existing)

In Table 8, resource usage amounts of activities are summarized. Allocation of costs to cost pools can be performed based on those amounts.

After the total expenses and resource drivers are determined, costs are allocated to cost pools according to resource drivers as illustrated in Table 9. Allocation is performed through overhead rates that are factors used in allocating resources to cost pools.

Next, the activity costs are allocated to cost objects via activity drivers. For this insurance company, there are two separate cost objects regarding service activity: (1) for new deals (customer) and (2) for existing deals (customers). Sale closing activities are shared by new and existing deals. As a result, activity drivers, which are determined according to the type of business (i.e. insurance) the company is in, are used to allocate costs to actual service actions or activities. In order to utilize ABC to its fullest extent, entrepreneurs should spend time to identify each service activity for their industry as well as how these individual activities relate to each other. Then, they will be able to calculate true overhead allocations related to those activities.

Activities	Advertising	Loyalty	Communication	Std. Expense	Human Resource	Places Where Services Marketing Activity Is Performed	Interactive Marketplace
<b>A1 Promotion-Basic</b>	20,000 times	-	-	-	10 people	1300 sq. ft	-
<b>A2 Promotion-Loyalty</b>	-	100,000 renewals	-	-	-	-	-
<b>A3 Sales closing</b>	-	-	25,000 min.	25,000 deals	10 people	1200 sq. ft	13,500 (deals from web)
<b>Total</b>	20,000 times	100,000 renewals	25,000 min.	25,000 deals	20 people	2500 sq. ft	13,500 deals from web

Costs	Type	Amount of Costs	Resource Driver Total (a1)	Overhead Rate (b1)	Activities		
					A1 (a1xb1)	A2 (a1xb1)	A3(a1xb1)
Advertising	TV	\$100,000 per month	5,000 times	\$20 per times	\$100,000 [5000times*\$20/times]		
	Newspaper	\$80,000 per month	5,000 times	\$16 per times	\$80,000 [5.000times*\$16/times]		
	Websites	\$60,000 per month	10,000 times	\$ 6 per times	\$60,000 [10.000times*\$6/times]		
Loyalty	Discounts for Health Contracts	\$180,000	45,000 cont.	\$4 per cont.		\$180,000 [45.000 cont. *\$4.00 /cont.]	
	Discounts for Life Contracts	\$225,000	30,000 cont.	\$7.5 per cont.		\$225,000 [30.000cont.*\$7.50 /cont.]	
	Discounts for Vehicle Contracts	\$170,000	10,000 cont	\$17 per cont.		\$170,000 [10.000cont.*\$17.00 /cont.]	
	Discounts for Agricultural Contracts	\$ 65,000	15,000 cont.	\$ 4.33 per cont.		\$65,000 15.000cont.*\$4.33/cont.	

Costs	Type	Amount of Costs	Resource Driver Total (a1)	Overhead Rate (b1)	Activities		
					A1 (a1xb1)	A2 (a1xb1)	A3(a1xb1)
Communication	Health Ins.	\$10,000	7,500 min.	\$4 per min.			\$30,000 [7,500 min. \$4 /min.]
	Life Ins.		4,500 min.				\$18,000 [4,500 min. \$4 /min.]
	Vehicle Ins.		8,000 min.				\$32,000 [8,000 min. \$4 /min.]
	Agricultural Ins.		5,000 min.				\$20,000 [5,000 min. \$4 /min.]
Std. Expense	Electricity Water Heating Other	\$5,000 \$3,000 \$1,500 \$500	125,000 Deals	\$0.08 per Total Deals			\$10,000 [125,000 Deals * 0.08 \$/Total Deals]
Human Res.	Phone Web Advertising Planning	\$50,000	5 people 5 people 5 people 5 people	\$ 2,500 Per People	\$ 25,000 [10 people * 2.500 \$/people]		\$ 25,000 [10 people * 2.500 \$/people]
Places Where Marketing Activity Performed	Phone Web Advertising Planning	\$1,000 per month	500 sq. feet 800 sq. feet 700 sq. feet 500 sq. feet	\$0.40 per sq. ft	\$520 [1300 sq. ft * \$0.40 /sq. ft]		\$480 [1200 sq. ft * \$0.40 /sq. ft]
Interactive Marketplace	Deals	\$4,050 per month	13,500 Deal/Web	\$0.3 / Deal per Web	-		\$4,050 [\$0.3 /Deal per Web * 13.500 Deal per Web]
Total		\$ 1,045,050			\$265,520	\$640,000	\$139,530

In Table 10, the second phase of cost allocation process can be seen. In this last phase, already identified activity cost pool (a), activity drivers (b) and their corresponding deal numbers (c) are summarized. Overhead rate (d) can be calculated for each promotional activity (column a) to activity drivers (column c). Also, costs of promotional activities directed to existing customers to ensure loyalty and promotional activities to attract new customers can be calculated individually and in total (columns e and f).

Cost Pool (Activity)	Cost Pool (Activity) Total Amount (\$)	Activity Drivers	Activity Drivers Total Numbers	Overhead Rate (\$/deal)	Cost Objects	
					Services Marketing Activity for Existing Deals (Customers) (\$)	Services Marketing Activity for New Deals (Customers) (\$)
	(a)	(b)	(c)	(d)	(e)	(f)
<b>Promotion-Basic (A1)</b>	\$265,520	Number of Total Deals (New + Existing)	125,000 Deals	\$2.12416 (a/c)	\$212,416 <i>(d*100,000 deals for existing customers)</i>	\$53,104 <i>(d*25,000 deals for new customers)</i>
<b>Promotion-Loyalty (A2)</b>	\$640,000	Number of Existing Deal Renewals	100,000 Deal	\$6.4	\$640,000	-
<b>Deal (A3)</b>	\$139,530	Number of Total Deals (New + Existing)	125,000 Deals	\$1.11624	\$111,624	\$27,906
<b>Total Cost</b>					<b>\$964,040</b>	<b>\$81,010</b>
<b>Unit Cost (\$/deal)</b>					<b>\$9.64</b> <b>[\$964,040/100,000 Deals]</b>	<b>\$3.24</b> <b>[\$81,010/25,000 Deals]</b>

Through ABC approach, the illustrated insurance company can allocate total and unit costs of promotion activities, directed to existing and new customers, in detail. In traditional cost accounting, total costs of promotion are usually treated as costs of generating new customers. However, ABC identifies overhead costs related to each service activity, and help managers to make better strategy decisions.

### CONCLUSION

This study has explored a conceptual framework for ABC costing in service marketing, including how to allocate advertising and promotion costs in a hypothetical insurance company for one month. To get a better picture, entrepreneurs should do a similar exercise on revenue generation capabilities for new and existing customers as well as product, process costs related to both groups. Entrepreneurs can then decide how to invest their resources, time, and efforts in existing and new customers. Similar activity would also help in identifying the most profitable segments within their customer base.

Activity based costing ensures that capacity is better used and made available for higher paying customer segments, and that demand and supply are better managed, especially in high fixed-cost and complex service operations. Doing proper revenue management and segmentation is very difficult to do without knowing true costs of services related to all providers' activities performed for specific segments.

Efficient resource management, reduction of loss and waste, true costing, and pricing have been the most important objectives of business environments in the last several decades. Contemporary costing methods try to achieve these goals. One such method, activity based costing, which can be used in multiple service types, is quite effective for true costing because it emphasizes activities rather than volume. Hence, miscalculations caused by volume-based approaches can be prevented.

## REFERENCES

- Agbor, Job Nsor Napoleon, Jackson, and Okpachui Okang (2012), "Activity Based Cost Management Practices In Selected Manufacturing Firms In Calabar Export Processing Zone", *The Leajon Journal*, Vol. 3, No. 2, 1-10.
- Ahmed, Zaffar, M. Khyzer Bin. Dost, Abdual Jabbar Khan, W. Bukhari, and Ali N. M. H. Ain, (2011), "Activity-Based Costing. Is It From Pain to Joy?," *Interdisciplinary Journal of Contemporary Research In Business*, Vol. 3, No: 2, 994-998.
- Al-Basteki, Hasan and Sayed Ramadan (1998), "A Survey of Activity-Based Costing Practices in Bahraini Manufacturing Firms", *JKAU: Econ. & Adm.*, Vol.11, 17-29.
- Al-Omiri, Mohammad (2012), "The Motives Driving Activity-Based Costing Adoption: An Empirical Study of Saudi Firms", *Journal of American Academy of Business*, Cambridge, Vol.17, Issue.2, 64-77.
- Baines, Anna (1992), "Activity-Based Costing", *Work Study*, Vol.41, No.2, 12-13.
- Baird, Kevin M., Graeme L. Harrison, and Robert C. Reeve (2004), "Adoption of Activity Management Practices: A Note on the Extent of Adoption and the Influence of Organizational and Cultural Factors", *Management Accounting Research*, No.15, 383-399
- Bartolacci, Francesca (2004), "Activity Based Costing in Supply Chain Logistics Activities Cost Analysis", *Working Paper*, Universita Degli Studi Di Macerata, 1-8.
- Cardos, Ildikó Réka and Stefan Pete (2011), "Activity-Based Costing (ABC) and Activity-based Management (ABM) Implementation – Is This the Solution for Organizations to Gain Profitability?", Volume.32, Issue.1, 151-168.
- Carmo, Luis Pulo F. and Fernando Padovani (2012), "Advances and Challenges for Adoption of Activity Based Costing (ABC) by Public Sector: A Comparative Study of Brazil, Colombia, Uruguay and United States", *International Business Research*, 150-158.
- Chrongruskut, Wiriya (2002), "The Adoption of Activity Based Costing In Thailand", *Doctoral Thesis*, Victoria University, School of Accounting and Finance, 48-53.
- Cohen, Howard (2004), "Implementing an Activity-Based Costing Model", *Master Thesis*, Nelson Mandela Metropolitan University, 22-23.
- Compton, T. R. (1996)., "Implementing Activity-Based Costing," *The CPA Journal*, Vol. 66, 21-24.
- Doyle, Gerardine, Lisa Duffy, and Melissa McCahey (2008), "An Empirical Study of Adoption/Non-adoption of Activity Based Costing in Hospitals in Ireland", *UCD Business Schools Working Paper*, 1-43.



- 
- Fadzil, Faudziah Hanim Bt. and Abdelqader Rababah, (2012), "Management Accounting Change: ABC Adoption and Implementation", *Journal of Accounting and Auditing: Research & Practice*, DOI:10.5171/2012.349927 , 1-17.
- Garg, Ashish and Aamer Rafiq, (2002), "Using Activity Based Costing To Improve Performance," *Bank Accounting & Finance*, October, 5-8
- Gunasekaran, A. (1999), "A Framework for the Design and Audit of an Activity Based Costing System", *Managerial Auditing Journal*, Volume.14, Issue.3, 118-126.
- Johnson, H. Thomas and Robert S. Kaplan (1987), *Relevance Lost: The Rise and Fall of Management Accounting*, Boston: Harvard Business School Press, 22-30.
- Lovelock, C. and E. Gummesson (2004), "Whither Services Marketing?," *Journal of Service Research*, Vol. 7, No. 1, 20-41.
- Maelah, Ruhanita and Daing Nasir Ibrahim (2007), "Factors Influencing Activity Based Costing (ABC) Adoption in Manufacturing Industry", *Investment Management and Financial Innovations*, Volume.4, Issue.2, 113-124.
- Mishra, Braja B. and Ranjan K. Bal (2012), "Activity Based Costing: A Conceptual Study For Implementation In Housing Sector", *Search Journal* ,Volume.1, 1-17.
- Nassar, Mahmoud, Husam Aldeen Al-Khadash, and Alan Sangster, (2011), "The Diffusion of Activity-based Costing in Jordanian Industrial Companies", *Qualitative Research in Accounting and Management*, Volume.8, No.2, 180-200.
- Oker, Figen (2003), *Faaliyet Tabanlı Maliyetleme Üretim ve Hizmet İşletmelerinde Bir Uygulama*, Istanbul: Literatur Yayıncılık, 27-87.
- Salawu, Rafiu Oyesola, and Tajudeen John Ayoola, (2012), "Activity Based Costing Adoption Among Manufacturing Companies in Nigeria", *Journal of Modern Accounting and Auditing*, Volume.8, No.1, 40-45.
- Stapleton, Drew, Sanghamitra Pati, Erik Beach, and Poomipak Julmanichoti, (2004) "Activity Based Costing for Logistics and Marketing", *Business Process Management Journal*, Vol.10, No.5, 584-597
- Zeithaml, V., M.J. Bitner and D. Gremler (2006), "Services Marketing: Integrating Customer Focus Across the Firm," McGraw-Hill Irwin: New York, N.Y., 4<sup>th</sup> ed., 25-27.



# HELPING SMALL BUSINESS ENTREPRENEURS AVOID CRITICAL MISTAKES IN QUICKBOOKS ACCOUNTING SOFTWARE

**Andrew Schiff, Towson University**  
**Joseph Szendi, Towson University**

## ABSTRACT

*The publisher of QuickBooks accounting software claims that it is simple enough to be operated by entrepreneurs without prior training in accounting. However, many accounting professionals have found that QuickBooks users frequently lack a sufficient understanding of the operation of the software and the associated accounting concepts to record transactions correctly. The authors, through their external consulting activities, have trained over 500 small business entrepreneurs in the use of QuickBooks accounting software. As a result of these activities, we have identified 14 of the most common software-related and accounting mistakes made by users of QuickBooks. The purpose of this paper is to share these findings with entrepreneurs who use QuickBooks, and the consultants who advise them, to increase the accuracy of these transactions and the resulting financial statements and other financial reports.*

## INTRODUCTION

Vendors of accounting software for small businesses often tout how simple their products are for the end-user to operate. There are a number of vendors which serve this market (Burns, 2006; Elikai, Ivancevich & Ivancevich, 2007), but QuickBooks from Intuit dominates the market for small business accounting software purchased at retail stores in the United States (Needleman, 2008). McCraigh, et al. (2000) stated that “as the non-accountant’s accounting software, QuickBooks has greatly simplified that accounting process,” and Perry (2006) claimed that “QuickBooks is so easy to use that someone with little or no accounting background can start using the program right out of the box.” Christensen, et al. (2003) described QuickBooks as a “disruptive innovation.” The marketing material from accounting software vendors tends to reinforce this assertion. For example, Intuit’s Web site states that the QuickBooks user can “get set up and running quickly” and can “learn QuickBooks skills as you need them - in your own time, at your own pace” (<http://quickbooks.intuit.com>). Elsewhere, it states that QuickBooks Online was designed “to be as easy to use as possible. You don't need to know accounting” (<http://oe.quickbooks.com>).

These assertions of simplicity are attractive to small business owners, who have little time or interest in learning the details of accounting or accounting software operation. As Mucha-Aydrott (2003) remarked, “Many small business owners or new entrepreneurs start their business with one thing in mind, their product or service... frankly, most people don’t like accounting.” However, the reality experienced by these individuals is often quite different. Sleeter (2005) found that many small businesses “are now using some type of accounting software, most often QuickBooks, and they’ve hired bookkeeping staff (often with minimal if any accounting skills) to do the data entry. The lack of skills inevitably leads to errors in the QuickBooks data, which results in poor information for management.” Scott (2006) quoted a QuickBooks consultant who stated that “It’s so difficult to hire a good QuickBooks person. You really have to have a strong accounting background ... I’d have to say that about half of the work is really accounting-related and using the functions within the software.” McCraigh, et al. (2000) asserted that “no accounting package can be operated properly without a sufficient understanding of its features and functionality.” Long (2007) declared that “there is a wealth of opportunities for trouble-shooting and fixing mistakes and problems that clients have with their data files.” Schiff, et al. (2009) analyzed 1,000 questions submitted to the discussion forums for two popular QuickBooks user groups. They found that many of these questions revealed a lack of fundamental understanding concerning the operation of the software, accounting concepts and procedures, and related issues. Crawford and Long (2011) wrote that “accounting professionals indicated that as much as 60% of their billable time is spent troubleshooting or correcting client data files.”

The authors, through their external consulting activities, have trained over 500 small business entrepreneurs in the use of QuickBooks accounting software over the past 10 years. The settings have ranged from adult education classes, to teleconferences, to training programs sponsored by the Small Business Administration, to small group meetings. A variety of instructional material has been used, including Craig (2009), TLR (2010) and other products. The authors consistently found that while most participants were able to complete basic data entry tasks correctly, they often failed to grasp various underlying concepts and procedures that were essential to using QuickBooks correctly and to producing accurate results. A majority of these concepts and procedures pertained to the operation of QuickBooks itself, while the remainder related to proper accounting practices. The objective of this paper is to share these findings, and the appropriate corrective actions, with the entrepreneurs who use QuickBooks and the consultants who advise them so that they can produce more accurate accounting records and financial reports.

## BACKGROUND

With over 90 percent of the United States market for small business accounting software, QuickBooks has made the most aggressive attempt to appeal to the end user who does not have a knowledge of accounting. When compared to other, more traditional accounting packages, QuickBooks contains a number of unique features that have contributed to its popularity (some of which have subsequently been copied by competitors). Among the most significant are the following:

- 1) The main interface is organized around everyday business activities, rather than traditional accounting journals and ledgers
- 2) English-language commands are used, rather than accounting terms such as “debit” and “credit”
- 3) Mistakes can be easily deleted, and do not have to be “zeroed out” with correcting transactions
- 4) All transactions are combined into a single journal, rather than being separated among traditional accounting journals
- 5) A unique window called the “Register” enables certain transactions to be entered more efficiently
- 6) The accounting records do not have to be “closed out” at the end of each fiscal year before starting a new year
- 7) Various payroll tax returns can be printed automatically, and individual accounts can be linked to the year-end income tax return
- 8) Add-on applications, such as online banking and credit card authorization, can be integrated with the accounting software to increase transaction processing efficiency
- 9) Different versions of QuickBooks, which have been customized for specific industries or for multiple users, are available

But despite the simplicity and user-friendliness of QuickBooks compared to other accounting software, various features of how the program and its underlying design can make it more challenging to use than might be evident from a first impression. The challenges faced by QuickBooks users have been noted by many authors, as was mentioned above. Moreover, the proliferation of training and technical manuals, including those mentioned above and others (Biafore, 2012; Madeira, 2011); live training seminars offered by companies such as Real World Training and QBExpress; training DVDs (AExpert Systems, 2012; TeachUcomp, 2012);

instructional videos on Web sites such as YouTube and DailyMotion; and user groups such as <http://community.intuit.com/quickbooks> and <http://forums.quickbooksusers.com>, indicates that many entrepreneurs do not feel sufficiently knowledgeable to use QuickBooks “out of the box”. This conclusion is confirmed by the user-generated mistakes that we have observed repeatedly throughout our training activities over the past 10 years.

As stated above, the user-friendly interface of QuickBooks and available training manuals make it possible for most people to learn how to enter basic transaction data correctly. When mistakes are made, they are generally caused by an incomplete understanding of the terminology used by QuickBooks, the logic of the QuickBooks program, and an absence of the practical knowledge that can only be gained through years of professional experience. While each entrepreneur’s experience in using QuickBooks is unique to a certain extent, we have summarized our findings as trainers into what we believe are the 14 most frequently-occurring mistakes that are likely to affect the accuracy of the entrepreneur’s accounting records and financial reports. The mistakes listed below are shown in the approximate order in which they are likely to be encountered when setting up and using QuickBooks. A brief explanation of each mistake appears first, followed by a recommendation as to how it can be avoided. The recommendations are written under the assumption that the reader of this article will be advising the entrepreneur, but they can also be easily understood and implemented by the entrepreneur him/herself.

## FINDINGS

### 1. Income and Expense Accounts

QuickBooks simplifies the task of creating accounts for a business by including templates for many different types of industries. However, most entrepreneurs, particularly those who are just getting started, lack the expertise to fine-tune these accounts for their specific business. This is particularly true for income and expense accounts. As a result, new accounts are added on an ad-hoc basis and the resultant chart of accounts lacks a logical structure.

The easiest and most effective way to overcome this problem is for the entrepreneur to begin by creating income accounts that match how they choose to track their revenue (for example, food, beverages and catering for a restaurant). This should be followed by the creation of matching cost-of-goods-sold and inventory accounts. Doing so will provide a consistent structure for recording the purchase and sale of inventory. Even service businesses should create matching cost-of-goods-sold and inventory accounts, because we have found that many service businesses begin to purchase and sell products as they expand.

## 2. The Start Date

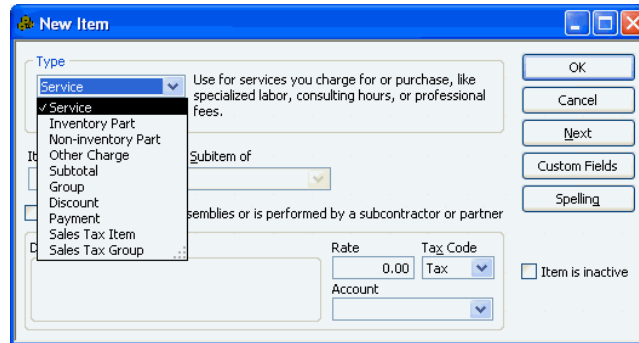
When creating the accounting records for a new business, QuickBooks asks the user to enter a Start Date. However, many entrepreneurs misunderstand the meaning of this term. It is not the day on which the business began operations, but rather the day on which the accounting records were transferred into QuickBooks. Therefore, the meaning of this term should be made clear to the business owner. In addition, if the Start Date is any day other than January 1st, there may be (i) non-QuickBooks accounting records from before the Start Date and (ii) QuickBooks accounting records from after the Start Date. In this situation, the business owner should generally seek the assistance of an accountant to combine both sets of accounting records to create financial statements for the entire year.

## 3. Opening Balances for Customers, Vendors and Inventory

Each time a new customer, vendor, or item of inventory is created, QuickBooks asks for the Opening Balance. This is the amount that is owed by the customer, owed to the vendor, or on hand as of the Start Date (the day on which the accounting records were transferred to QuickBooks). However, many entrepreneurs mistakenly believe that the Opening Balance is the amount of the first sale to the customer, the first bill from the vendor, or the first purchase of inventory. If any of these first transactions occur after the Start Date but are entered into the Opening Balance box, the financial statements for the current year will be incorrect. Therefore, the meaning of the Opening Balance box should be clearly explained to the business owner, and they should also be told that if they do not have the correct amount available that it can always be entered at a later time as a regular transaction.

## 4. Different Types of Items

In QuickBooks, unlike other accounting software, it is not possible to record a sale directly into the accounting records. It is first necessary to create something called an Item, and then sell it. The Item is linked to an Income account which will be automatically increased as a result of the sale. Further complicating matters is the fact that (i) there are different types of Items (see Figure 1), and (ii) while it is necessary to record a sale by selling an Item, it is not always necessary to record a purchase by buying an Item. This creates continuing confusion for many QuickBooks users.



*Figure 1*  
*Types of Items*

To help entrepreneurs comprehend the concept of Items as easily as possible, they should be told that they will primarily be selling only three types of Items. These will be (i) Services, for the sale of services, (ii) Non-Inventory Parts, for the sale of products where no running total of the quantity on hand is maintained, and (iii) Inventory Parts, for the sale of products where a running total of the quantity on hand is maintained. The consequences of choosing between these different types of Items are discussed in further detail below.

## 5. Creating Too Many Items

Most training guides incorrectly lead the entrepreneur to believe that they should create an Item for each individual service or product that they sell. For a typical small business, this can lead to the creation of dozens or even hundreds of Items, which is frequently more detailed than the owner needs and which slows down the processing of transactions. To alleviate this problem, the business owner should be advised that they can get started by creating just a few “all purpose” Items, each of which is linked to a specific income account (such as “food sales”, “beverage sales” and “catering sales”). The owner can then sell these “all purpose” Items over and over, while modifying the description and the selling price as appropriate.\* Only when it is important to track the sale of an individual service or product (e.g. “caviar”) would it be necessary to create an Item for that service or product alone.

\*They should be Service Items or Non-Inventory Parts, as will be explained in more detail below.

## 6. Overlooking the Simpler Periodic Method of Inventory

Just as most training guides lead the entrepreneur to believe that they should create many Items, they also direct the owner to maintain a running total of the quantity on hand of each product (i.e., the perpetual method of inventory). However, most small business owners are



familiar with what they sell, and in practice determine the quantity on hand with a quick physical count. Requiring the owner to record the purchase and sale of each product in the accounting records in order to maintain a running total is superfluous, time-consuming and is often done incorrectly.

This problem can be avoided by advising the entrepreneur to set up each “all-purpose” product Item, and each individual product Item for which they do not need to maintain a running total, as a Non-Inventory Part. The owner will be able to record the sales of these products as usual, but will not be required to record the individual products purchased. Instead, the owner can follow the simpler and widely-used small business practice of recording just the total amount of the purchase into the accounting records.\* They can then determine the quantity on hand of each product as needed with a physical count (i.e., the periodic method of inventory).

\* This would be done by clicking on the Expenses tab (see below) and selecting the Inventory or Cost of Goods Sold accounts.

## 7. The Expense Tab Versus the Items Tab

When using a window such as Write Checks or Enter Bills to record a cash or credit purchase, the owner must first select whether the purchase is an “Expense” or an “Item” before entering the transaction into the appropriate account. This can be a source of confusion because the Expense tab actually refers to anything that is bought or paid for with cash or credit, other than (i) an Item or (ii) the payment of a bill from a vendor. Consequently, the Expense tab would be selected not only to record an expense of the business, but also to record the purchase of an asset (such as supplies or equipment), or the payment of a non-accounts payable liability (such as an auto loan or a mortgage). In order to minimize confusion and possible errors when recording the latter types of transactions, the entrepreneur should be advised that the Expenses tab is used to record most purchases or cash disbursements, not just those for everyday operating expenses.

In contrast, the Items tab would generally be selected to record the purchase of products for which the entrepreneur wants to maintain a running total (Inventory Parts). To record the purchase of products for which the entrepreneur does not want to maintain a running total (Non-Inventory Parts), the Expenses tab should be selected and the purchase should be recorded into an Inventory or Cost of Goods Sold account(s). (Note: There are other situations in which the Items tab might be selected, but they are more advanced and less typical.)

## 8. Incorrect Running Totals of Inventory

A frequent complaint of entrepreneurs is that the running totals maintained by QuickBooks of the products that they sell do not match the actual quantities they have on hand. There are several ways in which this problem can be minimized, and hopefully eliminated. First,

to reduce the opportunity for such problems to occur, the entrepreneur should be advised to set up products for which they want to maintain a running total (Inventory Parts) only when there is a good business reason for doing so. In most cases this would be for the more valuable products or for those with serial numbers.

Second, the entrepreneur should be told to record the sales and purchases of such products only in the QuickBooks windows that contain a box to select an Item as opposed to just an account name and number. If they do not select the correct Item, its running total will not be properly updated. Examples of windows that contain a box for an Item include Create Invoices for sales, and Enter Bills for purchases. Examples of windows that do not include Make Deposits, the General Journal and various views within the QuickBooks Register. Finally, differences between the running totals of products in QuickBooks and the actual quantities on hand can be fixed using the “Adjust Quantity/Value on Hand” window.

## 9. Duplicate Names for Customers and Vendors

When recording a sale or purchase into QuickBooks, the customer or vendor can be selected from a pull-down list. However, the entrepreneur is often in a hurry when recording these transactions, and quickly types in the name of the customer or vendor rather than selecting it from the list. The problem that can arise when this happens is that if there is even a small difference between the typed spelling and the name on the list (e.g., “Co.” versus “Comp.”). QuickBooks considers it to be a new entity. As a result, the amount owed by the customer or to the vendor is spread among multiple accounts with slightly different spellings, making it more difficult to determine the total and to apply payments accurately.

In order to reduce this problem, the entrepreneur should be advised not to type the name of the customer or vendor until they have scanned the pull-down list and have verified that it is not available to be selected. (If the customer or vendor already exists with two slightly different spellings, they can be combined using the Edit button in the Customer Center or Vendor Center.)

## 10. Overstated Balance in Undeposited Funds

QuickBooks records cash sales and payments received from customers by increasing an asset account called “Undeposited Funds”. When the money is physically deposited in a bank, the owner is supposed to transfer the money from Undeposited Funds to the corresponding bank account. However, many entrepreneurs are not familiar with this procedure, which causes two problems. First, the Undeposited Funds account increases and increases because the money is never transferred out of it. Second, because checks and other payments are recorded as reductions of the bank account, the bank account balance drops and drops and eventually appears to be overdrawn.

There are two ways in which this problem can be avoided. First, the entrepreneur can be advised to always transfer money in the accounting records from Undeposited Funds to the bank whenever a physical deposit is made. Alternatively, the entrepreneur can change the default setting in QuickBooks to create a pull-down menu so that cash sales and payments received from customers can be deposited directly into a bank account. This is accomplished through the Edit → Preferences menu in the Home screen, and making the selections indicated in Figure 2.

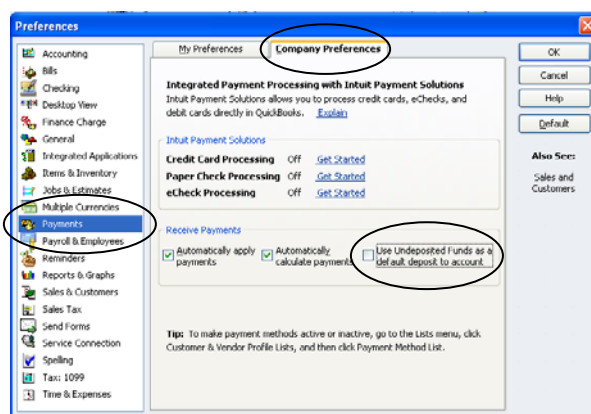


Figure 2  
Changing the Default Setting for Undeposited Funds

## 11. Using the Wrong Windows to Update Accounts Receivable and Payable

A common problem in QuickBooks is the failure of the entrepreneur to use the correct windows to record payments received from customers (“Receive Payments”), and to record payments of outstanding bills (“Pay Bills”). These are the only windows in which such transactions can be applied to specific customer invoices and vendor bills. If another window is used, the amount of the specific invoice or bill to which the payment should be applied will not be adjusted. In some cases, this may cause a customer to be given incorrect information about an amount due or a bill from a vendor to be overpaid. To make sure that this problem does not occur, the correct windows in which to record these transactions must be emphasized to the business owner.

## 12. Using the QuickBooks Register When Other Windows are Superior

As stated above, QuickBooks contains a unique feature called the Register that enables certain transactions to be entered more efficiently. Any account may be updated using the Register, which is shown in Figure 3. However, one of the limitations of the Register is that it

cannot record every element of certain transactions. For example, there is no box in the Register to select the specific invoice from a customer, or bill from a vendor, to which a payment should be applied. Moreover, it is not possible in the Register to record specific Items that are purchased, nor can sales tax be associated with a particular jurisdiction(s). This becomes a problem because entrepreneurs often record transactions into the Register that contain these elements, but leave them out because there are no boxes in which to enter them. Consequently, the customer, vendor, inventory, etc. information is not updated correctly. As mentioned earlier, this may lead to complaints from customers and overpayments of vendors, as well as over- or underpayments of sales tax and incorrect running totals of Inventory Parts.

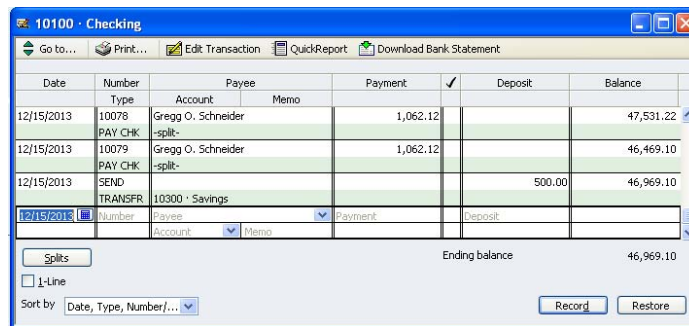


Figure 3  
The QuickBooks Register

In order to minimize the incomplete recording of the above types of transactions into the Register, the entrepreneur should be informed that there is a specific window in QuickBooks to record all of the information for every type of business transaction (Schiff, 2004). In reality, the Register does not have to be used at all. If the entrepreneur still wishes to use the Register because of its compact and efficient design, he/she should first confirm that every element of the transaction can be entered. Otherwise, the window in QuickBooks that has been specifically designed to record that transaction should be used instead.

### 13. Inaccurate Cash-Basis Financial Statements

Financial statements may be prepared using the “Accrual Basis” or the “Cash Basis” of accounting. The Accrual Basis of accounting includes sales and purchases made on credit, whereas the Cash Basis of accounting includes sales and purchases only when payment is received from the customer or when the bill from the vendor is paid. Most entrepreneurs use the Accrual Basis of accounting because it is more complete. However, some may switch to the

Cash Basis of accounting for a specific purpose, most often to prepare their tax return if it results in a lower reported income and tax liability.

QuickBooks has the ability, through the Edit → Preferences menu, to generate financial statements on either the Accrual Basis or the Cash Basis. If this is accomplished correctly, the Cash Basis financial statements should not contain any Accounts Receivable or Accounts Payable.\* However, it is not uncommon for QuickBooks to produce Cash Basis financial statements that include these accounts, due to the many ways in which transactions affecting these accounts can be recorded into the accounting records. Therefore, entrepreneurs who use the Accrual Basis of accounting to record sales and purchases, but who would like financial statements prepared under the Cash Basis as well, should be advised to have them compiled by an accountant to ensure that the above accounts are properly adjusted.

\* Also, all purchases of products should be added into Cost of Goods Sold, rather than Inventory.

#### 14. Attempting to Record Transactions That Require Accounting Knowledge

While QuickBooks simplifies the recording of many types of business transactions, there are a number that cannot be recorded correctly without some accounting expertise. The most common of these are (i) setting up the beginning account balances as of the Start Date, (ii) month-end and year-end adjusting entries such as depreciation, write-offs, accruals, etc., and (iii) transactions between the owner and the business, including business expenses paid through the owner's personal bank account or credit card, and the owner's personal living expenses paid through the business bank account or credit card.

Nonetheless, entrepreneurs routinely attempt to record these transactions even though they do not know the proper accounting procedures for doing so, and in the process are likely make mistakes that must be corrected by the accountant or tax preparer. When many of these transactions occur during the year, analyzing them and correcting the mistakes can be a time-consuming and expensive process. Therefore, the business owner should be told that if they are not sure how to record the above types of transactions (or any others) correctly, they are much more likely to have accurate financial statements and a lower tax return preparation fee if they consult with an accountant before doing so.

### CONCLUSION

Despite the simplicity and user-friendliness of QuickBooks compared to other accounting software, various features of the program and the complexity of certain types of accounting transactions can make it challenging to use properly. The authors, through our QuickBooks training and consulting activities, have found that most users can enter the details of everyday transactions correctly, but they often fail to grasp various underlying concepts and procedures in

QuickBooks that are essential to using it correctly and producing accurate results. In discussions with other accountants and QuickBooks ProAdvisors at events such as the AICPA Practitioners Symposium and TECH+ Conference ([www.aicpa.org](http://www.aicpa.org)) and the SNH QuickBooks Conference ([www.scalingnewheights.com](http://www.scalingnewheights.com)), we have learned that this problem is frequently encountered by other professionals as well.

Fourteen frequently-occurring mistakes that result from this lack of understanding, and that are likely to affect the accuracy of the entrepreneur's accounting records and financial reports, were described above. Some involved the unique terminology of QuickBooks, while others involved types of Items, maintaining accurate inventory records, default settings and procedures, duplicate or incorrect accounts, the proper screens in which to record various types of entries, and transactions normally requiring accounting expertise. Each mistake was followed by a recommendation(s) as to how it could be avoided.

Intuit, the publisher of QuickBooks, has attempted to address these concerns. First, it has created a Web page called the "Intuit Academy" with downloadable publications that provide guidance related to some of the above mistakes. In addition, Intuit has recently developed an automated feature called "Client Data Review" that can detect some of these errors and some others. Unfortunately, though, this feature is only contained in the version of QuickBooks designed for accountants, not the versions that are generally purchased by small business owners. There are also the publications and Web sites referenced in earlier sections. It is our belief that, by sharing our findings with the entrepreneurs who use QuickBooks and the professionals who advise them, we are contributing to the resources that will enable them to use this product effectively and produce reliable financial statements and other reports.

## REFERENCES

- AExpert Systems, Inc. (2012). *QuickBooks companion*. Towson, MD: AExpert Systems, Inc.
- Biafore, B. (2012). *QuickBooks 2013: The missing manual*. Sebastopol, CA: O'Reilly Media.
- Burns, M. Customer survey roundup No. 2. *CA Magazine.com*. Retrieved June 15, 2013 from [http://www.camagazine.com/index.cfm/ci\\_id/30457/la\\_id/1/print/true.htm](http://www.camagazine.com/index.cfm/ci_id/30457/la_id/1/print/true.htm)
- Christensen, C., Raynor, M. & Scott D. (2003, January) Six keys to creating new-growth businesses. *Harvard Management Update*, pp. 1-6.
- Craig, A. (2009). *QuickBooks in the classroom 2010*. Mountain View, CA: Intuit, Inc.
- Crawford, D. & Long, M. (2011). *Intuit Academy: Most common QuickBooks mistakes and how to fix them*. Plano, TX: Intuit, Inc. Retrieved June 20, 2013 from <http://learn.intuit.com/learncenter.asp>
- Elikai, F., Ivancevich, D. & Ivancevich, S. (2007, May). Accounting software selection and user satisfaction: Relevant factors for decision makers. *The CPA Journal*, pp. 26-31.
- Long, M. L. (2007). *Successful QuickBooks consulting*. Scotts Valley, CA: CreateSpace Publishing.
- Madeira, L. (2011). *Intuit Academy: QuickBooks at year-end 2012*. Plano, TX: Intuit, Inc. Retrieved June 20, 2013 from <http://learn.intuit.com/learncenter.asp>
- McCraigh, J., Woodard, J. & Sleeter, D. (2000). *Successful QuickBooks software consulting (Second Edition)*. Pleasanton, CA: The Sleeter Group, Inc.

- Mucha-Aydlott, J. (2003). *Computerized bookkeeping in layman's terms*. Santee, CA: San Diego Business Accounting Solutions, Inc.
- Needleman, T. (2008, July 7-20). Entry-level software 2008: It's far more than basic. *Accounting Today*, 22(12), 20-23.
- Perry, G. (2006). *Show me! QuickBooks 2006*. Indianapolis, IN: Que Publishing.
- Schiff, A., Lubich, B. & Giordano, E. (2009). An investigation of the ease-of-use claims of entry-level accounting software vendors. *Journal of Global Information Technology*, 4 (1&2), 34-42.
- Schiff, A. (2004). Help your QuickBooks clients with a frequent activities reference. *Pennsylvania CPA Journal*, 74, (4), 18-19.
- Scott, R. (2006, June). Getting it right. *Accounting Technology*, p. 34.
- Sleeter, D. (2005, April-May). Dealing with client QuickBooks data: Analyze the data file. *CPA Technology Advisor*, p. 36.
- TeachUcomp, Inc. (2012). *Mastering QuickBooks made easy*. East Lansing, MI: TeachUcomp, Inc.
- Technical Learning Resources, Inc. (2010). *Get going with QuickBooks 2010*. Rochester, New York: Technical Learning Resources, Inc.





# USING SOCIAL NETWORKS TO BUILD BUSINESS CONNECTIONS: ENGAGEMENT AND INTERACTIVITY ON GUAM'S RESTAURANTS' FACEBOOK PAGES

Lilnabeth P. Somera, University of Guam

## ABSTRACT

*Social network sites (SNS) have forced companies, long used to communicating with customers through ad campaigns and press releases, to figure out to reach customers who expect the direct, more transparent, and personal access they have come to expect from SNS. Those used to traditional communication channels may find the engagement and interactivity inherent in SNS challenging. This study conducted an analysis of Guam restaurants' Facebook pages and their levels of engagement and use of interactive strategies. The results revealed that only 49.3% of restaurants in Guam had a Facebook page. Content analysis of these pages indicates that they vary significantly from inert pages that are merely online brochures, to a few which have posts and other interactive elements that keep their customers or "fans" engaged, and respond in timely and appropriate interactions. Results suggest that having a web page appears to be related to Facebook engagement, suggesting that cross-platform facility with SNS could be a benefit to restaurants and other companies developing their web presence.*

## INTRODUCTION

When online social networks sites (SNS) like Facebook were originally developed, they were envisioned to connect friends, people in interpersonal relationships. However, the potential for using SNS as a tool for building business relationships was quickly recognized.

As of March 31, 2012, Burston-Marsteller's Global Social Media Check-up (2012) reported that Facebook has over 901 million active users. On September 14, 2012, the number of Facebook users surpassed the one billion mark (Facebook Newsroom, 2012).

The percentage of Fortune Global 100 companies that has a Facebook page has grown from 54% in 2010 to 74% in 2012. According to the same report (Burston-Masteller, 2012), the average corporate Facebook community has increased by 275% since 2010. Facebook pages connecting members of these communities are updated weekly by 93% of these companies, an increase from 54% in 2010. However, only 70% actively respond to posts or comments on these pages, which suggests variations in levels of interactivity in these online interactions. Some companies may build these Facebook pages and use them in a passive way, in the same manner that brochures are left on counters without anticipation of immediate feedback.

Facebook activity in Guam mirrors the global trends to a certain extent. There are 58,799 current Facebook users in Guam (as of the first week of February, 2013), which represents a 36.84% penetration of the total population, and 65.23% of the online population (Social Bakers, 2013). Interestingly, this figure actually represents a significant drop in the number of Facebook users over the last six months. There were 71,280 Facebook users in Guam in early September, 2012, which represented 34% of the population (Social Bakers, 2013).

Other secular trends may account for this change, including larger issues regarding online privacy and co-dependence on social media. Facebook's IPO earlier in 2012 may also be a factor (particularly for those who feared that the drive for profit would inexorably change the SNS), as well as some calls for "digital detox" after suggestions were made about the possibility that Facebook addiction may be another subcategory of the internet spectrum addiction disorders (Karaikos et al., 2010). Furthermore, a survey by the Pew Research Institute (December, 2012) reports that there is "considerable fluidity in the Facebook user population." They found that 61% of current Facebook users indicate that they have taken a voluntary break from Facebook for several weeks or more. Moreover, the survey found that 20% of online adults are former Facebook users.

Despite this "fluid" population, companies have not been deterred from building their own Facebook pages, and using it as a means of establishing connections with individual customers. According to emerging frameworks based on customer management theory, SNS make it easier for customers to interact with one another and other companies. Hence, customer engagement, defined as "a behavioral manifestation toward the brand or firm that goes beyond transactions (Verhoef et al., 2010)," can be developed through the interactions in SNS. Van Doorn et al. (2010) identify various behaviors which contribute to customer engagement, including "WOM (word of mouth), blogging, providing customer ratings and so on." The authors also "specifically discuss multiple dimensions of customer engagement, which include valence, form and modality, scope, impact, and customers' purpose. They also propose that customer characteristics, firm initiatives, and the environment (or, as they state, a context factor) affect customer engagement behaviors (p. 249)."

Dholakia and Durham's (2010) experiment on the effect of a restaurant's Facebook page (Dessert Gallery - DG) on increasing its customer base yielded mixed results. While the email interactions with the customers who participated in their study yielded an increase in Facebook fans, the overall gain was only 2.1% in a three-month period. The authors point out that "this narrow appeal is not unique to DG's customers. In an analysis of 50 Zagat-rated Houston restaurants, Facebook pages averaged just 340 fans, despite the fact that the restaurants had thousands of customers (p. 1)." They suggest that cautious optimism would be prudent, and that "companies should see what Facebook can do for them, but use it as one niche tool (p. 1)."

Facebook is indeed a unique tool, which spans traditional advertising, marketing, and public relationships approaches. It allows companies to "react in the moment, now more than ever (Coon, 2010, p. 5)" and is forging a new era of transparency and engagement (Gordgamer, 2009)." He further asserts that "Companies now face a clear choice: wall themselves in and become increasingly controlled and hidden, or use social media and other means to reveal their human side, welcome transparency, and forge new relationships with their customers." To what extent companies are doing this in Guam is the issue addressed in this study.

Two research questions are thus asked in this study:

*RQ1 : What is the level of interactivity of the communication strategies used in the Facebook pages of restaurants in Guam?*

*RQ2 : To what extent does the information in the Facebook pages of restaurants in Guam indicate engagement with their customers?*

## FACEBOOK PAGES OF GUAM RESTAURANTS

The focus of the present study is a business area that is at the heart of the tourism industry in Guam – restaurants. Specifically, what SNS strategies do restaurants in Guam use to reach their customers and build relationships with them? To what extent do their Facebook pages reflect engagement with their customers?

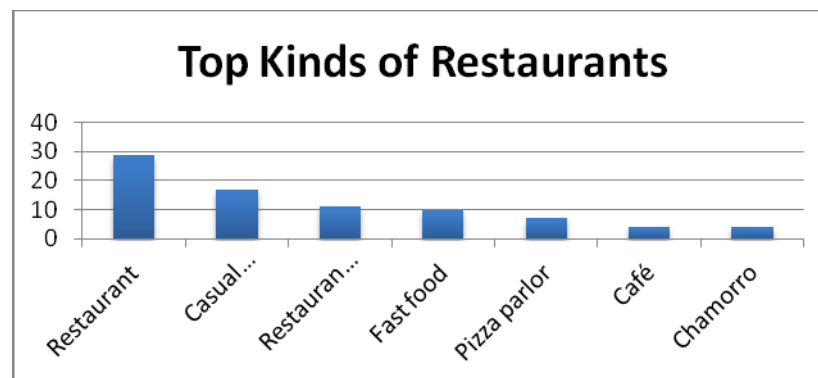
### The Sample

The 2012 Guam Phone Book contained a listing of two hundred nine (209) restaurants. Restaurant names were plugged into the Facebook search engine to determine if they had Facebook pages. Those that did were rated on measures of engagement and interactivity. Content analysis on the Facebook pages was conducted and indicators of interactivity and engagement were tabulated.

Of the 209 restaurants listed in the phone book, 103 restaurants (49.3%) had Facebook pages. They were categorized according to the type of restaurant and cuisine listed in the Guam Food Guide ([www.guamdiner.com](http://www.guamdiner.com)).

Fifty-three (53) types of restaurants were listed. The top seven categories are shown in Figure 1 below. Three or more restaurants were listed under each of these categories. Fifty-three (53) per cent of the restaurants used in this study (N=109) are listed, which only includes categories with more than three (3) restaurants.

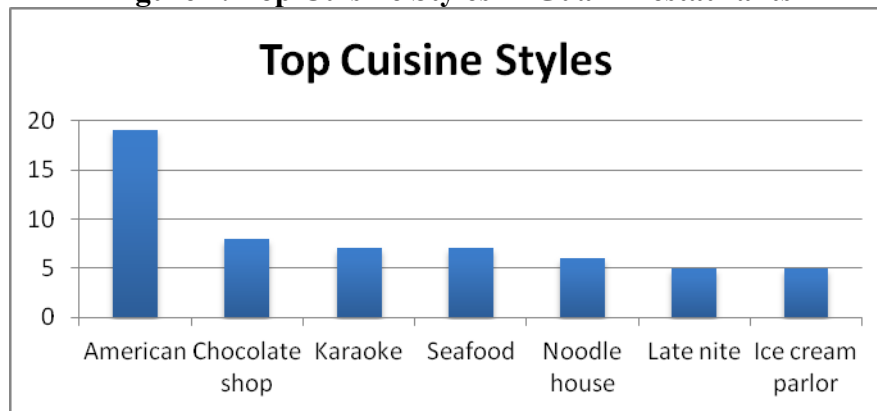
**Figure 1. Top Kinds of Restaurants in Guam**



This figure lists restaurants with more than 3 restaurants in each category.

Figure 2 below shows the top seven cuisine styles identified in Guam restaurants, from the Guam Diner's list of 51 cuisine styles. Styles included have more than three (3) restaurants identified with the cuisine style. "Karaoke" and "late night" categories do not seem like cuisine styles, and some raters had identified more than one category (e.g. American, karaoke). In such cases, the first category identified was included in the list. This list of restaurants of the top cuisine styles represents 75% of the 109 restaurants that have Facebook pages.

**Figure 2. Top Cuisine Styles in Guam Restaurants**



This figure lists the top cuisine styles in Guam restaurants – categories with more than 3 restaurants are shown here.

## Instrument

The restaurants' Facebook pages were analyzed using indicators of interactivity and engagement. Items were developed following Verhoef et al.'s (2010) definition of engagement. (See Appendix A.) Codes were developed for the raters to use, and common themes in the responses to the open-ended items were identified.

Typical Facebook page features like the "about" statement and basic information were rated along with the number of "likes" on the page as well as the number of people "talking about this." The number and types of photos on the page were noted, along with the posts, responses to posts, and posts by others. The effectiveness (timeliness and appropriateness) of responses to posts were also rated.

## Methodology

Students in a senior capstone course were randomly assigned a set of Facebook pages to rate. Each student was given a list of approximately 14 restaurants. Ratings were tabulated in Excel and later imported into SPSS (Statistical Package for the Social Sciences, Version 20, 2011).

## RESULTS

Out of the 209 restaurants listed in the 2012 Guam phone book, one hundred and three (49.3%) had Facebook pages. A caveat – some restaurants probably opened after the publication of the phone book and may not be in the list. In addition, there are three phone books in circulation (a surprising fact, considering the size of Guam’s population), so there is a possibility that some restaurants may not be listed in this phone book. However, it is the telephone company’s official phone book, so these concerns may be unwarranted.

Ratings of the “about” statement are presented in Table 1 below. This statement represents the company’s “greeting” on the page, as it is the initial information that viewers see. Ratings on a scale from 1 (bland) to 4 (makes me want to go to the restaurant) had a mean of 1.64 (s.d., 1.05) which suggested that many of the “about” statements were not very engaging, to say the least.

	Frequency	Valid Percent
Bland	49	57
Okay	16	18.6
Enough to make me read info	15	17.4
Makes me want to go to the restaurant	6	7
Total	86	100
System missing	17	
Total	103	

The basic info ratings were not much better, although the mean score was slightly higher at 1.73 (s.d., 1.04) on a 4-point scale, as shown in Table 2.

	Frequency	Valid Percent
Incomplete	51	53.7
Basic	21	22.1
Most info	14	14.7
“Over the top”	9	9.5
Total	95	100
System missing	8	
Total	103	

The number of “likes” on the Facebook pages ranged from 0 to 2156, with the mean at 200.1 (s.d., 480.87). A local franchise was excluded from the analysis, as the number of local likes was not separated from the global Facebook page, which had over six million likes. Table 3 below shows the number of likes aggregated in increments of 500. The mean was 200 likes, with a standard deviation of 480.87, which indicated the very broad range of response to the

restaurant Facebook pages, ranging from 0 likes (N=7) all the way to 2516 likes. As Table 3 illustrates, 83% of the restaurants (N=83) had less than 500 likes.

	Number of restaurants	Valid Percent
Less than 500 likes	83	83
Between 500-1000	4	3
Between 1001-1500	6	5
Between 1501-2000	6	5
More than 2000	4	4
Total	103	100

Another variable which supposedly captures how engaged the Facebook “fans” are is the number of fans “talking about this.” The average number of fans talking about the restaurant Facebook pages was 10.67 (s.d. 32.99), with the range from 0 to 232. The SPSS frequency run indicates that 93.8% (N=90) of “talking about this” frequencies were below the mean, while only 6.2% (N=6) had “talking about this” scores ranging from 42 to 232.

If the visual element is a factor in engaging the audience, the photos on the Facebook page may be a possible factor. 44.8% of the pages had photos of food, while 20% had photos of their staff. In addition, 23.8% had photos of the restaurant itself.

The timeliness of posts was examined, and the results are presented in Table 4.

	Frequency	Valid Percent
None	51	54.8
More than a month old	19	20.4
More than a week old	5	5.4
Within this week	18	19.4
Total	93	100
System missing	10	
Total	103	

As Table 4 shows, 54.8% of the restaurant Facebook pages do not have any posts. That is, the page only has the “about” statement, some basic information, probably some pictures. Moreover, no new information has been added since the page was built, and there is no sign of any interaction with customers. Of those that do have posts, 20.4% have posts that are more than a month old, 5.4% have posts more than a week old, and 19.4% have posts within the week that the data were gathered.

Responses to posts are indicators of interactivity and engagement. Table 5 shows various types of responses to posts on the Facebook pages. 64.2% of the posts did not receive any response, while 16% were “liked.” Only 1.2% received any comments, while 18.5% received a combination of likes and comments.

	Frequency	Valid Percent
None	52	64.2
Likes	13	16
Comments	1	1.2
Likes and comments	15	18.5
Total	81	100
System missing	22	
	103	

Raters are asked to indicate their overall impression of the Facebook page on a 4-point scale ranging from “bland” to “interactive features.” The mean rating of 1.69 (s.d., 1.25) appears consistent with the ratings of other features of the Facebook page, which were presented earlier in Tables 1 and 2.

	Frequency	Valid Percent
Bland	46	61.3
Basic	6	8
Some visual appeal	14	18.7
Interactive features	9	12
Total	75	100
System missing	28	
	103	

Information about the use of other SNS was also obtained. The results indicate that forty-three per cent (43%) of these restaurants also had a corresponding web page, which may indicate a broader web presence. A limited number have Twitter and Youtube accounts as well, but the numbers are too low to warrant discussion here.

An independent-samples t-test was conducted to compare indicators of Facebook engagement in restaurants that also have web pages and those who don't, on the premise that SNS facility and web presence in other platforms might have an effect on interactions initiated on the Facebook page. The results of an independent-samples t-test in SPSS using “having a web page or not” as the grouping variable suggest that there is a significant difference in the mean scores of all indicators of Facebook engagement ( $p < .05$ ), with the exception of the number of people “talking about this.”

As Table 7 demonstrates, the differences between the Facebook engagement indicators of restaurants that have and don't have web pages are significant. For restaurants that have web pages, their Facebook “About” statements are perceived as more engaging, their basic information more complete and impressive. They also have significantly more “likes” and posts. In addition, they received more varied and interactive responses to their posts. Finally, they have significantly more favorable overall impressions.

	Web page	N	Mean	s.d.	t	df	<i>p</i>
About Statement	No	52	1.27	0.56	-6.869	83	<b>0.00</b>
	Yes	33	2.48	1.06	-6.045	44	<b>0.00</b>
Basic info	No	56	1.32	0.66	-6.635	92	<b>0.00</b>
	Yes	38	2.50	1.06	-6.096	57	<b>0.00</b>
Number of likes	No	56	138.64	369.94	-3.659	92	<b>0.00</b>
	Yes	38	553.82	722.12	-3.265	50	<b>0.00</b>
Talking about this	No	53	6.00	19.29	-1.807	87	0.07
	Yes	36	19.03	47.10	-1.572	43	0.12
Posts	No	54	0.52	0.95	-3.878	90	<b>0.00</b>
	Yes	38	1.42	1.29	-3.68	64	<b>0.00</b>
Responses to posts	No	50	0.26	0.69	-5.325	78	<b>0.00</b>
	Yes	30	1.47	1.33	-4.6	39	<b>0.00</b>
Overall Impression	No	44	1.11	0.92	-5.751	71	<b>0.00</b>
	Yes	29	2.55	1.21	-5.437	49	<b>0.00</b>

## **DISCUSSION, FUTURE RESEARCH DIRECTIONS, AND RECOMMENDATIONS**

The results presented in the previous section provide some insights about the interactivity of the communication strategies used in the Facebook pages of restaurants in Guam, which is the focus of the first research question. The strategies range from the inert pages in which no posts have been made since the Facebook page was built (online “brochures” which left to gather dust on a virtual counter), to the very dynamic pages where there is active, timely, and innovative interaction between the restaurant and the customers, and among the customers and their networks.

Content aimed at increasing the level of engagement, such as “about” statements and basic information blocks are particularly beneficial to those who are trying to reach new customers or audiences. As one rater commented, “some old restaurants don’t even have a Facebook, but they are still popular among the locals and tourists. It is important, then, to keep in mind that SNS and web presence is just “one niche tool,” as Dholakia and Durham (2010) point out. Facebook’s “narrow appeal,” to use their terms, seems to appeal to those who are already regular users of other platforms, hence the significant difference in the levels of engagement of Facebook pages that are linked to web pages compared to those which are not.

Audience analysis could be an interesting progression from this study – for example, it seems reasonable to suggest that restaurants frequented by younger customers, who are more likely to have their mobile phones with them when they go to restaurants, would have more evidence of engagement on their pages (postings of food, comments about their restaurant experiences, even complaints). They are also more likely to take advantage of online promotions, and use the ever-expanding options on Facebook to indicate where they are, what their current mood is, tag people and pictures, and other activities that would increase a restaurant’s reach into personal networks.



As far as the second research question is concerned, the results of study provides some evidence of the levels of restaurants' levels of engagement in terms of the number of "likes," posts, and responses to posts. Timeliness appears to be a key factor; delayed responses may communicate an underlying sense of uncaring, lack of concern, even disorganization, which can affect the overall impression of the Facebook page, and ultimately, the restaurant or the organization it represents. There seems to be an expectancy that SNS "conversations" are always in progress, and the lack or delay in response conveys a sense of disregard or abandonment of the listener or the audience. If the conversation is discontinued, does that mean the relationship has ended?

Herein lies the problematic of bridging the conventions of social relationships with business ones. While we may rekindle personal relationships after long absences, it may not be reasonable to expect the same of business relationships. With so many options as far as restaurants are concerned, it is imperative that the engagement with customers stays current, particularly when most decisions about "where to go for dinner tonight" are based on very recent information and spur-of-the-moment reactions (such as seeing a friend's post of the dessert they had at a certain restaurant yesterday).

However, while it is tempting to argue that if your Facebook page engages your customers, they will patronize your product or your services (the "If we build it, they will come" argument), there is apparently more to customer engagement than simply building an online relationship.

What needs more examination is the customer-to-customer interaction that is facilitated by Facebook and other SNS, e.g., someone's refusal to go to a restaurant because of a friend's comment, or sharing pictures of a delectable dish or a new venue. Regression and correlational analysis might shed some light on the predictors of customer engagement, patronage of products and services, and satisfaction with the relationship with the company.

Restaurants who want to attract new customers and build long-term relationships through their Facebook pages should develop creative strategies to engage them, keep them coming back to the page, and ultimately make them cross the thresholds of their establishments. First of all, posts have to be updated regularly (daily, or at the very least, weekly). Second, novel and innovative promotions have to be created. For example, one restaurant offered discounts to first-time visitors who "liked" them on Facebook. Another offered different promotions depending on the day of the week, while another had a competition for rating the different flavors of a drink and naming popular dishes. Third, visual rhetoric from the establishment should carry the message, i.e., pictures (with the immediacy of elements of lighting, composition, color, etc.) can be used to effectively convey taste, value, and attractiveness of the restaurants' cuisine as well as its atmosphere. Fourth, the page managers should always respond as soon as possible to posts from customers. The perception that someone is there at the other end of the communication line should be conveyed consistently, regardless of whether the post is positive or negative. In fact, it is even more imperative to respond to a negative post, such as a complaint about the food or the service. A virtual explanation or apology, as necessary, can avert a post from going viral and generating a slew of undesirable responses. Conversely, the appreciation of a positive post can help develop long-term relationships, one Facebook friend or fan at a time..

## **ACKNOWLEDGEMENT**

The following students assisted with the Facebook page ratings: Candice Ananich, Robert Balajadia, Tiffany Bourgeois, Ariel Buccat, Nickolas Camacho, Bianca Cruz, Daisy Lynn Demapan, Colin Leon Guerrero, Vanessa Malumay, Jesse Mangham, Rogelio Orio & Tasha Wade. Tiffany Arriola and Jasmin Stole were also co-presenters of an earlier version of the paper at the CLASS Research Conference, University of Guam, March 12, 2013.

## **REFERENCES**

- Burston and Marsteller. "The Global Social Media Check-up 2012." Retrieved on February 15, 2013 at <http://www.slideshare.net/BMGlobalNews/b-m-global-social-media-checkup-2012-deck-13341217>.
- Coon, M. (2010). *Social Media Marketing: Successful Case Studies of Businesses Using Facebook and YouTube With An In-Depth Look into the Business Use of Twitter*. Unpublished manuscript MA thesis, Stanford University.
- Dholakia, U.M. & Durham, E. (2010). "One café's Facebook experiment." *Harvard Business Review*, 1. Facebook Newsroom. Retrieved February 17, 2013 from <http://newsroom.fb.com/content/default.aspx?NewsAreaId=22>.
- Gordgamer, S. (2009). "4 Ways Social Media is Changing Business." Retrieved on February 16, 2013 from <http://mashable.com/2009/09/22/social-media-business/>
- Guam Food Guide (2013). Guam Restaurant Directory. Retrieved on January 5, 2013 from <http://www.guamdiner.com/directory/guam/index.php>
- Pew Internet and American Life Project (2012). "Coming and going on Facebook." Retrieved on February 16, 2013 from <http://www.pewinternet.org/Reports/2013/Coming-and-going-on-facebook.aspx>.
- Somera, L., Dalisay, F. & A. Forbes (June, 2013). "Online Intergenerational Communication of Young Adults in the United States, Australia, and Guam: Perceptions and Engagement." Paper accepted for presentation at the Annual Conference of the International Communication Association, London, UK.
- Karaiskos, D., Tzavellas, E., Balta, G., & T. Paparrigopoulos (2010). "Social network addiction: a new clinical disorder?" *European Psychiatry*, 25, 855-Statistical Package for the Social Sciences, Version 20 (2011).
- van Doorn, J., Lemon, K.N., Mittal, V., Nab, S., Pick, D., Pirner, P. & P.C. Verhoef (2010). "Customer Directions," *Journal of Service Research*, 13 (3), 253-266.
- Verhoef, P.C., Reinartz, W.J., & M. Krafft (2010). "Customer Engagement as a New Perspective in Customer Management." *Journal of Service Research*, 13: 247-252.

## APPENDIX A – CODING SHEET

CODING SHEET						
RESTAURANT	Date viewed	Type	Cuisine style	Facebook	"About" statement	Basic info
Name	day/mo/year	See categories Sheet2	See categories Sheet3		Rate appeal	Rate completeness of info
				1=Yes 0=No	1=Bland 2=Okay	1=Incomplete 2=Basic info
					3=Enough to make me read all the info	3=Most info
					4=Made me want to go there for dinner tonight	4=Over the top
<b>Example</b>						
Aji Ichi	31/01/2013	11	30	1		
Likes	You like?	Talking about this	Photos	Types of photos	Posts	Webpage Basic info
Actual #		Actual #		1=Food 2=Resto staff 3=Venue	0=None 1=More than a month old	
	1=Yes 0=No		1=Yes 0=No	4=Other	2= More than a week old 3=Within this week	1=Yes 0=No
258		31	1			
Response to posts	Posts by others	Types of posts by others	Response to posts by others	Effective-ness of response		
0=None 1=Likes		Brief description	0=None 1=Yes	0=Not at all 1=Good		
2=Comments 3=Likes and comments	0=None 1=Yes			2=Very good, timely and appropriate		



---

# **FIXING THE TAX GAP: ELECTRONIC MEANS FOR THE INTERNAL REVENUE SERVICE TO EMBRACE**

**Edwin J. Wu**

## **INTRODUCTION**

The Internal Revenue Service (“IRS”) is the government agency responsible for the collection of taxes and enforcement of the tax laws. Abiding by its duty, the IRS today “collects more than \$2 trillion in tax revenue [each year], and deals with more Americans than any other institution, public or private” (Rossotti, 2000). Considering its annual budget of \$11 billion, it is admirable that the IRS manages to collect revenue approximately a hundred times more than its cost (Rossotti, 2000). Nonetheless, due to its position and place in our society, the IRS continues to be the subject of intense scrutiny. In evaluating the IRS, the government found that public expected the IRS “to do a far better job in serving the public” (Rossotti, 2000). Subsequently, the IRS worked on improving itself to meet these expectations.

Still, the IRS primarily focuses on its mission statement: collecting the proper amount of tax (Rossotti, 2000). Even with the IRS’s enforcement of the tax laws, some taxpayers fail to pay their fair share of the taxes, contributing to the tax gap. This tax gap refers to the yearly difference between the taxes due and the amount actually paid, which is estimated to be approximately \$345 billion dollars (U.S. Department of the Treasury [Treasury], 2007). While people fail to pay their taxes for various reasons, problems arise when a number of these people purposely cheat and do not pay their fair share. In particular, the largest portion of the tax gap is comprised of small businesses and self-employed taxpayers (Treasury, 2007). Incidentally, these taxpayers go unpunished because their incomes are not be subject to the information reporting requirements, come in the form of cash not easily detected, or both (Treasury, 2007).

To address these issues, Congress and the IRS instituted a number of improvements to reduce the tax gap. These improvements included: simplifying the tax code, increasing information reporting requirements, employing harsher penalties, and using other methods. Particularly, the information reporting requirements have been attributed to one of the main factors for the United States’ high tax compliance rate (U.S. Government Accountability Office [GAO], 2007).

The problem with enforcing the tax laws is the asymmetric information advantage held by the taxpayers (Lederman, 2010). Typically, the taxpayers know the facts of their tax situations or at least have ready access to that information. In contrast, the government must play catch-up and obtain that information from either the taxpayer or other third parties. These information reporting requirements provide the IRS with the necessary information to evaluate whether taxpayers are paying their taxes. Recently, Congress enacted new legislation to increase

the information reporting requirement for electronic payments, Internal Revenue Code section 6050W (“6050W”), Returns Relating to Payments Made in Settlement of Payment Card and Third Party Network Transactions.

Since January 1, 2011, 6050W imposes new information reporting requirements on financial institutions and businesses by requiring them to report to the IRS the net dollar amount paid through credit cards, debit cards, and stored-value cards (collectively referred to as “electronic card payments”) in a calendar year. This requirement intends to crack down on the businesses that fail to report accurately their gross income (Treasury, 2006). Thus, it should reduce the tax gap because the new requirements allow the IRS to compare aggregate net payments through the electronic card payments reported by the businesses with the amounts reported by financial institutions. Additionally, the legislation may strengthen the public’s image in the IRS’s ability to enforce the tax laws, thereby increasing the perception that the tax system is fair and that people comply with their taxes (Johnson, 2003).

This Article evaluates the effect of 6050W and its likely influence on the underreporting aspect of the tax gap. To evaluate 6050W, the Article applies these six factors: 1) arm’s-length parties, 2) bookkeeping infrastructure, 3) centralization, 4) complete reporting, 5) few alternative arrangements, and 6) contributor to the tax gap (Lederman, 2010). This six-factor test provides a basis for evaluating the effect of 6050W. Following the pattern of legislation and increased information reporting, this Article envisions that 6050W may lead to an eventual future where the government replaces the cash economy with an entirely electronic payment system.

With an entirely electronic payment system, the IRS will be able to fully utilize the 6050W because the new information reporting requirements create the necessary trail for the IRS to determine whether taxpayers are paying their fair share. A conversion to an entirely electronic payment system may seem like an improbable task, but this development may not be that far off considering the technological advances and the worldwide adoption of credit cards thus far. Therefore, this Article explores the tax policy implications associated with moving to an entirely electronic payment system and why embracing this change can benefit the IRS and increase the amount of revenue it raises.

## **THE TAX GAP PROBLEM**

Reducing the tax gap has been a goal since the 1980s and it continues to be a prominent part of discussions especially in light of the recent economic crisis and growing U.S. budget deficit (GAO, 1994). This tax gap represents the annual amount of noncompliance with the tax laws (Rifkin, 2009). According to a recent IRS study, the estimated tax gap for 2001 is \$345 billion dollars which does not even include all unpaid taxes. This estimated \$345 tax gap is comprised of three main forms of noncompliance: (1) underreporting income (\$285 billion, 82.5 percent of the tax gap); (2) underpaying taxes due and owing (\$33 billion, 9.7 percent of the tax gap); and (3) non-filing or late filing of tax returns (\$27 billion, 7.8 percent of the tax gap) (U.S.

Treasury Inspector General for Tax Administration [TIGTA], 2008). Importantly, noncompliance does not arise solely from evasion or cheating (Treasury, 2007).

There are two main reasons to reduce the tax gap. First, it enables the government to increase revenue without raising taxes. For Congress and the IRS, it is politically attractive to go after these noncompliant taxpayers because they already owe this amount. As such, Congress views this as an easier way to raise revenue and lower the deficit compared to raising taxes (Book, 2009). Even though the United States has the one of the highest rates of voluntary compliance in the world with a rate 83.7%, any increase in the compliance rate can lead to large sums of revenue (Treasury, 2007; Cords, 2005). By increasing voluntary compliance by 1%, revenue increases by an additional \$25 billion each year (Rifkin, 2009). Therefore, while the Government must expend additional money to enforce the tax laws, the enforcement actions are worth it as long as the revenue collected is greater than the cost of enforcement.

Second, from a fairness viewpoint, reducing the tax gap is necessary to correct the inequity it creates among compliant taxpayers and noncompliant taxpayers enjoying government services. Unfortunately, the noncompliance encumbers the compliant taxpayers because they also pay for the noncompliant taxpayers' share. Estimates show that if the noncompliant taxpayers paid their fair share, each compliant taxpayer could receive a \$2,000 tax rebate (Cords, 2005). By reducing this inequity, it fosters public confidence that everyone pays their fair share to support the government which in turn should create more compliant taxpayers (Olson, 2003). With this image of fairness, each compliant taxpayer then feels that they are not being taken advantage of by the cheating taxpayers.

However, efforts to reduce the tax gap can also become a trap. While hunting for additional revenue, it may not bring the expected results or worse because prosecuting tax evasion requires increased scrutiny on each and every taxpayer. This increased scrutiny may lead to the opposite effect: decreasing the satisfaction with the IRS and spurring more noncompliance. Accordingly, the government should be reluctant to penalize all noncompliance too harshly (Bankman, 2007). Care must be taken to avoid making it seem like a witch hunt, which in turn hurts the voluntary tax compliance rate. On a larger scale, care must be taken to ensure that tax gap hunt is not so extreme that it hampers economic growth by overburdening taxpayers and businesses with tax requirements. At the same time, it is important to acknowledge that reducing the tax gap to zero is impossible because there will always be some form of unavoidable noncompliance.

Now, of the \$345 billion, the largest component of the tax gap is the underreporting income (Treasury, 2007). About \$109 billion of this tax gap is attributed to the underreporting by small businesses and self-employed taxpayers (Treasury, 2007; Bankman, 2007). The study estimates that these businesses report less than half of their income (Treasury, 2007, Bankman, 2007). It is believed that the reason for this underreporting deals with the fact that the businesses are involved in the "cash" sector as opposed to the "non-cash" sector (Bankman, 2007). The

cash sector consists of businesses that primarily deal in cash transactions and may in fact only accept payments in cash (Bankman, 2007).

In the cash sector, it is suspected that many people cheat on their taxes (Toder, 2007). In fact, underreporting income may be the norm or even expected for cash sector businesses to remain competitive (Bankman, 2007). Nonetheless, these noncompliant taxpayers evade prosecution partly because the tax information asymmetry makes it difficult for the IRS to detect this tax evasion. The IRS simply lacks access to all the information that the taxpayers have about their tax situations. Therefore, it becomes important for the IRS to use information reporting to its fullest extent possible to reduce the tax gap.

### **REDUCE THE TAX GAP THROUGH INCREASED INFORMATION REPORTING**

The voluntary tax compliance rate is around 83.7%, which is said to be “surprisingly high, given that audit and penalty rates are not high enough to make compliance the economically rational choice” (Lederman, 2010, at 1734). While enforcement actions make compliance more rational, much of the voluntary compliance occurs due to the third parties withholding taxes on income and information reporting requirements on payments and other forms of income (Bankman, 2007). Accordingly, it is believed that the information reporting requirements are most effective in gaining voluntary compliance (Treasury, 2008).

Through information reporting, as the taxpayer’s actions become more apparent to the IRS, it in turn increases the probability of detection for an audit (Lederman, 2010). Because of the increased probability of an audit, taxpayers are then more likely to be voluntarily compliant. Supporting this premise, a government report showed that the compliance rate is strongly correlated to whether a taxpayer’s activities are subject to withholding and information reporting requirements (GAO, 2007; Binkley, 2007). In fact, it showed that compliance rate decreased as the information reporting requirements decreased: around 99 percent compliance with withholding and substantial information reporting requirements, around 95 percent compliance with substantial information reporting requirements, around 91 percent compliance with some information reporting requirements, and around 46 percent compliance with little to no information reporting requirements (GAO, 2007).

As these statistics show, the compliance rate is the lowest without withholding or third-party information reporting requirements. Without these requirements, it creates the greatest opportunity for noncompliance. Accordingly, the small businesses and self-employed taxpayers evade the IRS the easiest because their tax information is the least visible. Thereby, these taxpayers compose the largest portion of the tax gap (GAO, 2007).

Information reporting is important in addressing this issue. One, it reduces the information asymmetry between taxpayers and the IRS. Taxpayers have the advantage as they are the ones who know the facts regarding their tax activities in the first place. Typically, the IRS can only learn about the taxpayers’ information after the fact (Rettig, 2006). Without third-



party reporting, the IRS would be forced to rely only on the taxpayers' accounts of the taxes. Two, information reporting allows the IRS to perform effective tax enforcement. Otherwise, the IRS would be blindly searching for noncompliance.

In essence, information reporting requirements encourage the public to believe that the government is aware and watching, which likely spurs the taxpayers' voluntary compliance (Lederman, 2007). With this in mind, the information reporting requirements help address the tax gap problem. The issue is whether 6050W allows for better information reporting to deter the activities that facilitate tax evasion (Morse et al, 2009).

## **6050W INFORMATION REPORTING REQUIREMENT**

On July 30, 2008, Congress passed Internal Revenue Code section 6050W ("6050W") as a part of the larger legislation Housing and Economic Recovery Act of 2008. Until 6050W took effect, the previous tax laws required taxpayers to submit information reports, Form 1099s, to the IRS. As part of their reporting obligation, businesses must file a Form 1099 to the IRS when payments made to each recipient totaled \$600 or more in the course of their trades or businesses in a calendar year.

6050W sets forth new information reporting requirements for financial institutions and businesses. The effect of the new tax law aims at reducing the tax gap by increasing the information reporting standard (Treasury, 2006). These requirements are revamped to decrease the incentive for tax evasion and at the same time increase the revenue brought in. Estimates show that the additional information reporting requirements will bring in approximately an additional \$18.7 billion over the next ten years (Bickley, 2008).

The new tax law states an information report must be filed by any "participating payee," meaning any party that accepts credit cards, debit cards, and stored-value cards (collectively referred to as "electronic card payments") as payments. In other words, after January 1, 2010, the new law 6050W requires that financial institutions and businesses to file information returns with the IRS reporting the amount of electronic card payments a business receives during a calendar year. Moreover, the new tax law is broad enough that it also encompasses online transactions. However, 6050W does not concern electronic card payments to foreign businesses and government units.

Along with reporting the electronic card payments, the businesses must also include the name, address, and tax identification number (TIN) of the payer. Until the businesses verify the TINs of the payers, the electronic card payment processors must withhold 28 percent of the businesses' transactions. With the identifying information of the payers, IRS can accurately track and match the information together.

To ensure that 6050W does not become an excessive burden, Congress created the *de minimis* exception. The *de minimis* exception provides that taxpayers only have to file these information returns regarding these electronic card payments if both 1) the aggregate value of a

taxpayer's transactions exceed \$20,000 and 2) the aggregate number of transactions exceeds 200. Accordingly, the exception suggests that it may be designed to exempt small businesses such as small auctions and garages sales from these information reporting requirements (Lederman, 2010).

### **Analysis of the 6050W Information Reporting Requirements**

To evaluate the information reporting requirements of 6050W, the Article uses these six factors: 1) arm's-length parties, 2) bookkeeping infrastructure, 3) centralization, 4) complete reporting, 5) few alternative arrangements, and 6) contributor to the tax gap (Lederman, 2010). These six factors provide a standard to determine if 6050W will effectively reduce the tax gap. It will be effective as long the reporting requirements are not too burdensome and achieve its goal in encouraging compliance. As such, 6050W should help reduce the tax gap because the heightened information reporting requirements reduce the information asymmetry and help promote the image that all taxpayers pay their fair share of their taxes.

First, arm's length parties refer to parties that are independent and on equal footing. When the taxpayer and other party are arm's-length parties, it decreases the possibility of the parties colluding to avoid information reporting requirements or falsifying the information to the IRS. Without accurate information, the IRS cannot properly enforce the tax laws. Here, the parties would more than likely be at arm's-length because the possibility of collusion between financial institutions and businesses is small. Typically, the financial institutions act as the middlemen for the sales between the two different parties. By being the middlemen, the financial institutions merely facilitate the electronic card payments between the parties and do not benefit from assisting any underreporting. Instead, these financial institutions benefit from an accurate reporting of these payments because they charge both a flat fee and a percentage fee of the total transaction amount (Levitin, 2008). Therefore, this setup does not incentivize financial intuitions to underreport because they make a percentage of the total transaction amount.

Second, with a strong bookkeeping infrastructure, information reporting becomes more efficient. With electronic card payments system, a report of goods and services purchased is logged automatically with the financial institutions (IRS, 2004). Currently and likely since the first credit cards were issued, these companies track consumer purchases for three primary reasons: marketing, fraud detection, and risk management. Therefore, with every purchase on a credit card or debit card, the card issuers record and log each transaction into a database. However, 6050W does not require the tracking of any cash transactions because the section is only directed at electronic card payments. Therefore, cash transactions go undetected at the financial institutions. Again, it becomes incumbent to rely on businesses and self-employed taxpayers maintaining their bookkeeping to confirm the accuracy of these electronic card payments along with the cash transactions.

Third, going hand-in-hand with a strong bookkeeping infrastructure, information reporting is more efficient when the information is centralized through the economies of scale. Larger taxpayers, like the financial institutions, present lower compliance costs per unit tax remitted and collected. Subsequently, the IRS can enforce the tax laws more easily because financial institutions are fewer in number, have known locations, and significant economic incentives to comply with government mandates (Lederman, 2010). In contrast, the small businesses and self-employed taxpayers do not provide the IRS the same advantage in reducing that tax gap.

Fourth, complete reporting makes information reporting most effective because the government has all of the information to match third-party reports with the corresponding amounts on the taxpayer's return. Instead, partial information reporting reduces this enforcement efficiency because the IRS must work to fill in the information gaps. Until the information gaps are filled, it places the IRS at no better position on the information asymmetry scale. Now, the financial institutions should have complete reporting because all of the consumers' electronic card payments flow through the financial institutions. At the same time, there may be a number of duplicated electronic card payment transactions reported to the IRS because of the reporting requirements for other tax code sections. Because 6050W may overlap with these other requirements, the worry is that the duplication may be extensive and overly burdensome for businesses. On the other hand, it can be also argued that these transactions place minimal burdens because the businesses already report these transactions.

Additionally, another problem is that 6050W does not require the parties to report the basis for the goods and services paid through the electronic card payments. Thus, the reporting entities like the middlemen financial institutions have "no reliable way of knowing the taxpayer's basis in the goods" (Lederman, 2010). To verify the taxpayer's basis, the IRS must still use an audit. Another issue arises in regards to cash transactions. While 6050W captures all of the electronic card payments, it fails to capture the cash income. People can bypass this reporting requirement by simply using cash or other substitutes like bartering on craigslist.org. Nonetheless, the complete reporting of the electronic card payments should prove useful. It presents a measure to compare the total income generated from the cash income to the electronic card payments. Understandably, there may be differences between each industry and the prevalence of electronic card payments.

Fifth, there should be few alternative arrangements because this prevents taxpayers from finding ways to avoid the information reporting requirement. With fewer alternative arrangements, information reporting is more effective and results in fewer distortions. Here, there are several ways for people to bypass IRC 6050. First, the legislation itself offers an alternative arrangement, the participant payee must have engaged over two hundred transactions and the aggregate payments of these two hundred transactions exceed \$20,000. The *de minimis* exception may be designed to prevent imposing a significant reporting burden on smaller taxpayers, like casual sellers on eBay or at garage sales (Lederman, 2010). For example, at a

garage sale, taxpayers are selling their personal items that result in personal, nondeductible losses because the goods typically sell for less than what the taxpayers originally paid for it (IRS, 2007). However, this *de minimis* exception may also lead sellers to circumvent the legislation by either limiting the number of transactions or limiting the transaction dollar amount. For example, taxpayers may split the multiple transactions among family members or other related parties (Lederman, 2010). Second, 6050W only covers the electronic card payments, not cash transactions. Thus, using cash transactions entirely bypasses 6050W. Third, 6050W does not capture any electronic card payments through foreign businesses and government units. As such, 6050W again may be circumvented by making transactions with foreign businesses and government units. While there may be other methods, these examples demonstrate that circumventing 6050W is possible.

Sixth, the issue should be a contributor to the tax gap. Information reporting is not efficient if the amount at stake is not substantial enough to justify the costs. If these are not prime targets to reduce the tax gap, the IRS should not waste time reviewing and incurring costs to process the information returns. Here, the underreporting by businesses makes up the largest portion of the tax gap that 6050W should help reduce. Cash transactions offer these taxpayers the greatest opportunity to avoid their taxes. It is estimated that about \$109 billion of this tax gap each year is attributable to underpayment of taxes on business income by individuals (Treasury, 2007).

Through a field study, it suggested that without accurate third-party reporting, most taxpayers in cash businesses do not comply because this type of tax evasion is expected and these taxpayers happily share information to facilitate the tax evasion (Wenzel, 2005). Nonetheless, a number of businesses do accept electronic card payments. Moreover, these businesses have online retail components that must use electronic card payments such as credit cards, debit cards, and Paypal. Then, as long as businesses do not solely accept cash transactions, the IRS can compare aggregate payments through the electronic card payments reported by the businesses with the cash payments reported. Therefore, the IRS can make determinations whether these businesses are underreporting their incomes.

In evaluating all six factors, these factors point to the fact that 6050W should lead to better information reporting standards to reduce the tax gap. Unfortunately, 6050W does increase the information reporting burden on businesses and individuals alike. In one estimate, tax compliance may cost employers with less than 20 employees a total of \$1,304 per employee (U.S. Small Business Administration, Office of Advocacy, 2005). Accordingly, small business owners insisted that they be allowed to use the National Taxpayer Advocate's proposals of voluntary self-reporting and voluntary withholding instead (Olson, 2006). However, this reporting burden may be initially high because it is a new change, but the burden should decrease significantly once the small businesses adjust to the learning curve. At the same time, these cost estimates may be inflated because these businesses may already abide by these reporting obligations through other sections of the tax code. Further, the market may alleviate the burdens

through technology, like software designed to automatically provide the necessary information reporting. For example, TurboTax is a popular tax preparation program that significantly lowers the costs of tax preparation.

### **FUTURE OF 6050W TO AN ALL-ELECTRONIC PAYMENT SYSTEM**

For 6050W to be fully effective in reducing the tax gap, it may require a shift in how payments are processed in the United States. Currently, the cash transactions are the major exception from 6050W. Since 6050W requires reporting for all electronic card payments, it is clear how this tax law can become the most effective. As such, the ideal and effective use of 6050W requires a conversion from a cash payment system to an all-electronic payment system. While this Article does not suggest an overnight shift, it merely explores the tax policy implications from a conversion to an all-electronic payment system.

For this conversion, this Article envisions that the electronic payment system would build off of the already-existing electronic payment system in place for credit cards and debit cards. The financial industry laid down an extensive foundation with its credit cards and debit cards (Nilson Report, 2010). One, the financial industry installed much of the necessary infrastructure for the conversion because most businesses and merchants already provide their customers the opportunity to pay with a credit card or debit card. Two, the credit card companies managed to encourage numerous consumers to get a credit card or debit card and use it regularly. As a result, in 2005, over half of the payments for goods and services are paid in an electronic format (Taxpayer Advocate Service [TAS], 2007). Therefore, while this conversion to an all-electronic payment system now may seem unlikely, this conversion is not novel and may be in the United States' future.

### **OVERVIEW OF TECHNOLOGY INNOVATIONS PROPELLING ELECTRONIC PAYMENT SYSTEM**

As time passes, with the advent the internet and growing use of the electronic payments, technology continues to improve and become more commonplace in today's society. The current technology makes this proposal of converting to a wholly electronic payment system a possibility. In the past, the predecessors of the modern credit card involved merchants extending credits to their frequent customers. These merchants issued their own proprietary cards that were only accepted locally and for limited purposes. While it is unclear when the modern credit card was created, Diner's Club, a card issued by American Express, may be the first modern credit card (Credit Card History, n.d.). Nonetheless, in 1958, American Express issued the first widely accepted plastic charge card (Credit Card History, n.d.).

Today, the use of the electronic payment system has grown so popular that it now makes up more than half of the payments for all goods and services in the United States (TAS, 2007).

According to one estimate, “[c]ash and checks accounted for only 45 percent of the payments in 2005, down from 57 percent in 2001” (TAS, 2007). For the remaining amounts, electronic card payments must then account for approximately 55% of all payments (TAS, 2007). While cash continues to be a significant part of the market, it is reasonable to believe that electronic card payments will continue to grow to become even more dominant (Papadopoulos, 2007). Therefore, it is provident to start preparing towards a future where all payments are made electronically.

In conjunction with the credit cards, technology helped propel the use of electronic payments. Through the increased use of the internet, it reshaped people’s expectations about every aspect of their lives as people are constantly turning to the internet for information, communication, and shopping. Similarly, the internet’s power and ease of use have impacted tax administration and enforcement. Computers are now central to the tax return preparation and filing process because computers can operate at speeds many times faster than before (Soled, 2007). In increasing numbers, taxpayers submit their completed tax returns through the internet (Bankman, 2008). In fact, many state governments and even the federal government provide taxpayers with the ability to prepare and submit their tax returns directly online (Soled, 2007).

With these advancements in technology, the world is now a far different place than it once was. These technological changes fundamentally transformed the way people live their lives. Therefore, this change towards an all-electronic payment system is achievable.

## **AN ALL-ELECTRONIC PAYMENT SYSTEM IS NOT NOVEL**

Aside from the growth of the credit card, the introduction of an all-electronic payment system is not novel. The United States would not be the first to consider such a move. In fact, Singapore introduced and established a cashless society by using electronic money, known as Singapore Electronic Legal Tender (“SELT”) (Papadopoulos, 2007). Moreover, an electronic payment system was a popular topic in Europe as several European countries contemplated their move to a new currency, the Euro (Papadopoulos, 2007). However, a number of these electronic payment systems were delayed or abandoned because of the difficulties in its implementation (Papadopoulos, 2007).

While no system has successfully replaced cash entirely, an example of an electronic payment system working seamlessly includes Hong Kong. In 1997, Hong Kong introduced a contactless smartcard, Octopus Card, originally “developed as an electronic payment device for the city’s various public transport systems” (Li, 2008). Subsequently, the Octopus Card expanded its use and doubled as a credit card, debit card, and other uses such as a membership card to track attendance and group benefits (Li, 2008). As the world’s leading and most extensive smartcard system in the world, 95 percent of Hong Kong residents use the Octopus Card on a daily basis accounting for an “average of 11 million financial transactions everyday

worth about US\$12.9 million” (Cheng, 2010). The ultimate success of the Octopus Card may be tested as it extends its reach into China and beyond (Cheng, 2010).

Considering the number of countries experimenting with electronic payment systems, it emphasizes that the idea of an all-electronic payment system is not novel. Therefore, in advocating an all-electronic payment system, this change will modernize the country and bring the IRS into the next century. Through 6050W and the electronic payment system, it heightens the information reporting standard. As such, the heightened standard helps resolve the longstanding issues of the tax gap and helps promote the image of fairness that all payers are paying their fair share of the taxes.

### **DIFFICULTIES REPLACING THE CASH PAYMENT SYSTEM WITH AN ENTIRELY ELECTRONIC PAYMENT SYSTEM**

The implementation of an all-electronic payment system will not come easy. Even though much of the necessary infrastructure and work has already been completed by the financial industry, many difficulties still face the all-electronic payment system. While these difficulties do not directly involve tax policy implications, these difficulties are worth mentioning to address practical concerns of the Article’s proposal.

#### **Costs:**

Foremost, the costs dictate whether the electronic payment system could be implemented. It is unclear how much it would cost to implement this change or how to best achieve the necessary level of people using these electronic payments. Aside from the costs of the framework, infrastructure, and implementation, the electronic card payments have high transaction costs compared to cash. The high transactions costs happen because the financial institutions charge interchange fees to the merchants accepting the electronic payments. In 2000, the average cost per transaction for credit cards is \$0.72, for checks is \$0.36, for on-line (PIN) debit cards is \$0.34, and for cash is \$0.12 (Levitin, 2008). These statistics demonstrate that cash at least two and half times cheaper than other forms of payment (Humphrey et al, 2003).

One major reason for the high transaction costs for electronic payments is that the credit card companies offer reward programs for using the electronic payment (Levitin, 2008). Unfortunately for the consumers using only cash, they absorb the majority of the transaction costs for electronic payments because merchants are restricted from passing the higher transaction costs on the different payment methods (Levitin, 2008). This may unfairly target the low-income to incur the brunt of the transaction costs because they typically pay in cash (Levitin, 2008). Additionally, some users may not have the fiscal responsibility to use an electronic payment system considering the \$876.76 billion dollar revolving debt in 2006 (Board of Governors of the Federal Reserve System, n.d.; Furletti & Ody, 2006).

However, in the system with an all-electronic payment, it will remove the unfair subsidization by the low-income or cash users in general. Moreover, in May 2009, Congress passed the Credit Card Accountability and Responsibility Disclosure Act of 2009 to ban a number of unfair strategies and practices in the credit card industry that is responsible for a large portion of the revolving debt. At the same time, for the transaction costs for electronic card payments to decrease, it will require the increased use of the electronic payments. As the use of the electronic payment cards increases, there should be an economy of scale to help reduce the transaction costs closer to the level of cash. Unfortunately, in the several pilot programs involved with solely electronic payment systems, the expected economies of scale did not lower the averaged fixed costs of the electronic payments (Papadopoulos, 2007).

### **Privacy Concerns**

Along with the cost concerns, the privacy concerns rank high in the United States. In contrast to China and Hong Kong, privacy issues may hinder the progress of its implementation in the United States. Over time, privacy concerns have grown exponentially with the changes in technology. Unfortunately, these concerns conflict with the needs of the government for information about the taxpayers' activities. While the government faces new and intense pressure to collect and use personal data to "reduce costs and enhance convenience, speed, efficiency, and accountability," the government is also expected to prevent this data from falling into the wrong hands (Justice Powell, 1976; Cate, 2008).

Furthering these fears, the Supreme Court ruled that taxpayers have no legitimate expectations of privacy in information held by third parties which means the government has complete access (Cate, 2008). Unfortunately, nowadays, third parties hold all of the taxpayers' personal information whether intentionally given or non-voluntarily given to them. Aside from the government watching, there are additional fears that this information may be stolen for identity theft or various scams. Even for purposes unrelated to fraudulent misuse, people become insecure knowing that their exact purchase and details can be identified for marketing or other research.

However, even without this all-electronic payment system, these concerns already exist. As such, this is another hurdle that can be remedied as the system is implemented and the issues are worked out. For example, the Octopus Card sidesteps this issue by having non-personalized Octopus Cards that do not store any of the user's personal information (Li, 2008). Perhaps, another remedy involves making sure that no individual information can be collected about the user for *de minimis* transactions.

### **Hardware Failures and Other Problems**

Without the physical, tangible currency in hand, there may be concerns of an electronic failure or mistakes in accounts. For example, there was a massive panic about the Y2K bug where people feared that a computer programming error would wipe out their bank accounts.



Similarly, people may be concerned about an electronic glitch or mistake because it may cause someone to lose all access to their account. However, these are not new issues considering that practically no one holds onto all of their money themselves. Instead, most people entrust their money to financial institutions which hold the people's account information in the computers. Nonetheless, these financial institutions are strongly incentivized to keep this information secure and without problems.

Additionally, there may be other concerns such as hardware failures. If the machine is broken or the card is not working correctly, nothing can be done. So far, technology demonstrated that there can be low rates of failure like with the Octopus Card. The Octopus Card's problem rate only suffered 28% failure within the last year (Li, 2008). It is expected that these error rates will only decrease with time. Now, there may be other problems that are not yet anticipated, but this Article counts on the people's ingenuity to resolve the problems as they occur.

## CONCLUSION

Reducing the tax gap is an important goal for the IRS because it is one the easier ways for Congress to increase revenue without new taxes. To further reduce the underreporting component of the tax gap, Congress enacted 6050W which increases the information reporting standard. This legislation intends to crack down on businesses who fail to report accurately their gross income. With the new information reporting requirements for financial institutions and businesses, it requires them to report to the IRS the net dollar amount paid through credit cards, debit cards, and stored-value cards in a calendar year.

Based on the six factors of 1) arm's-length parties, 2) bookkeeping infrastructure, 3) centralization, 4) complete reporting, 5) few alternative arrangements, and 6) contributor to the tax gap, 6050W should help reduce the tax gap. First, the taxpayer and other party should be arm's-length parties because it makes the possibility of collusion small. Without collusion, the information reported is more accurate. Second, there is a strong bookkeeping infrastructure with electronic card payments because the financial institutions already track purchases for their own purposes. Third, the information is centralized because the financial institutions perform the bookkeeping for all the taxpayers' electronic payments. Fourth, this provides the nearly complete reporting of electronic payment which makes the information reporting effective for IRS enforcement. Fifth, while there are some alternative arrangements to bypass 6050W, the majority of the businesses and self-employed taxpayers that the IRS is targeting will not be able to use these alternative arrangements. Sixth, this underreporting by businesses and self-employed taxpayers are contributors to the tax gap. In fact, their underreporting of \$109 billion comprises the largest portion of the tax gap.

Therefore, in evaluating all six factors, 6050W should lead to better information reporting standards to reduce the tax gap. With this information, it should allow the IRS to compare

aggregate net payments reported by the businesses with the amounts reported by financial institutions. Additionally, 6050W may have the effect of strengthening the image of the IRS that everyone pays their fair share, thereby increasing the perception that the tax system is fair and that people comply with their taxes. While 6050W increases the information reporting burden on the taxpayers, the burden should be minimal because they should already keep an accurate bookkeeping of their transactions.

Then, in a possible future, the replacement of the cash system with an all-electronic payment system will fully utilize 6050W. While many practical difficulties remain, the signs on the wall point towards a future with an all-electronic payment system. Already, more than half of the payments for goods and services are made through electronic card payments. By completely embracing this idea, it encourages further development and innovation to make this conversion feasible. In the end, with 6050W, an all-electronic payment system would further reduce the opportunities to cheat and hopefully the tax scofflaws would rather comply with the tax laws than go through all the trouble of trying to evade a system that leaves a clear trail for the IRS to follow.

## REFERENCES

- Bankman, Joseph (2007). *Eight Truths About Collecting Taxes From the Cash Economy*, Tax Notes, Vol. 117, at 506-07.
- Bankman, Joseph (2008). *Using Technology to Simplify Individual Tax Filing*, National Tax Journal Vol. LXI, No. 4, Part 2 at 774.
- Binkley, James (2007). *CRS Updates on the Tax Gap and Tax Enforcement*, Congressional Research Services. Retrieved April 10, 2012, from [http://assets.opencrs.com/rpts/RL33882\\_20070216.pdf](http://assets.opencrs.com/rpts/RL33882_20070216.pdf).
- Bickley, James (2008). *Tax Gap: Administration Proposal to Require Information Reporting on Merchant Payment Card Reimbursements*, Congressional Research Service at 2. Retrieved April 10, 2012, from <http://www.policyarchive.org/handle/10207/bitstreams/19300.pdf>.
- Board of Governors of the Federal Reserve System (n.d.), *Federal Reserve Statistical Release G.19: Consumer Credit Historical Data*. Retrieved Apr. 10, 2011, from [http://www.federalreserve.gov/releases/g19/hist/cc\\_hist\\_sa.txt](http://www.federalreserve.gov/releases/g19/hist/cc_hist_sa.txt).
- Cate, Fred (2008). *Government Data Mining: The Need for a Legal Framework*, Harvard Civil Rights-Civil Liberties Law Review, 435, 436.
- Cheng, Jonathon (2010). *Octopus Hopes to Expand in China*, Wall Street Journal Online, New York, NY., Mar. 31, 2010.
- Credit Card History (n.d.). In *Wikipedia*, Retrieved March 30, 2012, from [http://en.wikipedia.org/wiki/Credit\\_card#History](http://en.wikipedia.org/wiki/Credit_card#History).
- Cords, Danshera (2005). *Tax Protestors and Penalties: Ensuring Perceived Fairness and Mitigating Systemic Costs*, Brigham Young University Law Review 1515, 1522.
- Department of the Treasury (2006), *General Explanations of the Administration's Fiscal Year 2007 Revenue Proposals* at 117. Retrieved April 4, 2013, from <http://www.treasury.gov/resource-center/tax-policy/Documents/bluebk06.pdf>.

- Department of the Treasury (2008). *General Explanations for the Administration's Fiscal Year 2009 Revenue Proposals* at 63. Retrieved April 4, 2013, from <http://www.treasury.gov/resource-center/tax-policy/Documents/bluebk08.pdf>
- Furletti, Mark & Ody, Christopher (2006). *Measuring U.S. Credit Card Borrowing: An Analysis of the G.19's Estimate of Consumer Revolving Credit*. Retrieved April 2, 2013, from <http://www.philadelphiafed.org/pcc/papers/2006/DG192006April10.pdf>.
- Humphrey, David et al. (2003). *What does it Cost to Make a Payment?*, Review of Network Economics, Vol. 2, Issue 2 June 2003, at 159, 162-63.
- Internal Revenue Code § 6050W.
- Internal Revenue Service and United States Department of the Treasury (2007). *Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance*. Retrieved April 10, 2013, from [http://www.irs.gov/pub/irsnews/tax\\_gap\\_report\\_final\\_080207\\_linked.pdf](http://www.irs.gov/pub/irsnews/tax_gap_report_final_080207_linked.pdf).
- Internal Revenue Service (2004). *Merchant Category Codes to Determine Reportable Payment Card Transactions*, Internal Revenue Bulletin 2004-31, Revenue Procedures 2004-31.
- Internal Revenue Service (2007). *Reporting Auction Income and the Tax Gap*, Retrieved November 4, 2012, from <http://www.irs.gov/newsroom/article/0,,id=174478,00.html>.
- Johnson, Steven (2003). *The 1998 Act and the Resources Link Between Tax Compliance and Tax Simplification*. University of Kansas Law Review, Vol. 51, 1013, 1014.
- Lederman, Leandra (2010). *Reducing Information Gaps to Reduce the Tax Gap: When is Information Reporting Warranted?*, Fordham Law Review, Volume 78, 1733.
- Leandra Lederman (2007). *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, Stanford Law Review, Vol. 60, 695, 711.
- Levitin, Adam (2009). *Priceless? The Social Costs of Credit Card Merchant Restraints*, Harvard Journal on Legislation, Vol 45, 1, 7-8.
- Li, Michelle (2008). *Octopus Making Everyday Life Easier*. Retrieved April 3, 2013, from <http://michelleli.ca/wp-content/uploads/writings/octopus.pdf>
- Morse, Susan et al. (2009). *Symposium: Closing the Tax Gap, Cash Businesses and Tax Evasion*, Stanford Law & Policy Review, Vol. 20, 37.
- Nilson Report (2010). February Issue 943. Retrieved April 5, 2013, from <http://www.nilsonreport.com/issues/2010/943.htm>.
- Olson, Nina (2003). *Taxpayer Rights, Customer Service, and Compliance: A Three-Legged Stool*, Kansas Law Review, Vol. 51, 1239, 1244.
- Olson, Nina (2006). *National Taxpayer Advocate, Before the Committee on the Budget United States Senate on The Tax Gap and How to Solve It*.
- Papadopoulos, Georgios (2007). *Electronic Money and the Possibility of a Cashless Society*. Retrieved April 4, 2013, from <http://ssrn.com/abstract=982781>.
- Powell, Lewis (1976). Supreme Court Decision. *United States v. Miller*, 425 U.S. 435, 436.
- Rettig, Charles (2006). *Nonfilers Beware: Who's That Knocking at Your Door?*, Journal of Tax Practice & Procedures, Oct.-Nov. 2006, at 19, 19-20.
- Rifkin, Dave (2009). *A Primer on the "Tax Gap" and Methodologies for Reducing it*. Quinnipiac Law Review, Vol. 27, 375, 377.
- Rossotti, Charles (2000). Commissioner of the Internal Revenue Service, Internal Revenue Service. *Modernizing America's Tax Agency*. Retrieved, April 5, 2013, from [www.irs.gov/uac/Modernizing-America's-Tax-Agency](http://www.irs.gov/uac/Modernizing-America's-Tax-Agency).
- Soled, Jay (2007). *Homage to Information Returns*, Virginia Tax Review, Vol. 27, 371, 375.
- Taxpayer Advocate Service (2007). *2007 Annual Report to Congress*, 500-01. Retrieved April 3, 2013, from [http://www.irs.gov/pub/irs-utl/arc\\_2007\\_vol\\_1\\_legislativerec.pdf](http://www.irs.gov/pub/irs-utl/arc_2007_vol_1_legislativerec.pdf).

- Toder, Eric (2007). *What is the Tax Gap?*, Tax Notes, Vol. 117, at 367.
- U.S. Government Accountability Office (1994). *Tax Gap — Many Actions Taken, But a Cohesive Compliance Strategy Needed*. Retrieved April 10, 2013, from <http://archive.gao.gov/t2pbat3/151585.pdf>.
- U.S. Government Accountability Office (2007). *Tax Compliance: Multiple Approaches are Needed to Reduce the Tax Gap*. Retrieved April 4, 2013, from <http://www.gao.gov/new.items/d07391t.pdf>.
- U.S. Small Business Administration, Office of Advocacy (2005), *The Impact of Regulatory Costs on Small Firms*, SBHQ-03-M-0522, from <http://www.sba.gov/advo/research/rs264tot.pdf>.
- U.S. Treasury Inspector General for Tax Administration (TIGTA) (2008). *Additional Actions are Needed to Effectively Address the Tax Gap*. Retrieved April 10, 2013, from <http://www.treas.gov/tigta/auditreports/2008reports/200830094fr.pdf>.
- Wenzel, Michael (2005). *Motivation or Rationalisation? Causal Relations Between Ethics, Norms and Tax Compliance*. *Journal of Economics Psychology*, Vol. 46, 491, 504-05.