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Call for Articles

New England Journal of Entrepreneurship (NEJE), published twice a year by Sacred Heart University's College of Business, is intended to be an invaluable forum for exchange of scholarly ideas, practices, and policies in the field of entrepreneurship and small business management.

The *Journal* is currently seeking original contributions that have not been published or are under consideration elsewhere. The scope of the articles published in *NEJE* ranges from theoretical/conceptual to empirical research, with maximum relevance to practicing entrepreneurs. The *Journal* tries to appeal to a broad range of audience, so articles submitted should be written in such a manner that those outside of academics would be able to comprehend and appreciate the content of the material.

Format

Please submit four typed copies of your article, plus a CD-based version in Word or RTF format. On separate pages, include an abstract of the article (100 words maximum) and a biographical sketch of the author(s). A title page should precede the article and should list the name(s) of the author(s) as well as their full address (including phone and fax numbers and e-mail address). Papers are to be double-spaced with one-inch margins. References should be included on separate pages at the end of the paper. Manuscripts should be no longer than 20 pages of text and 25 pages total, including abstract, text, tables or illustrations, notes and works cited. Please consult APA style guidelines for all formatting details.

Copyright

The copyright of published articles will belong to the publishers of *NEJE*. Authors will be granted permission to reprint or otherwise use portions of their articles published in the *Journal* upon written request.

Review Process

All articles will be double blind refereed. Authors will receive reviewers' comments and the editors' publishing decision in approximately 90 days of submission.

All prospective authors are required to include a $20 submission fee with each manuscript sent in for consideration, payable to "NEJE." The fee will be used to cover administrative costs and will also provide the author with a year's subscription to the *Journal*.

Submission

Authors are encouraged to submit articles for the Fall 2005 issue by April 15, 2005. Papers received after the due date will automatically be considered for future issues of the journal.

All submissions and correspondence should be addressed to:

Editor, New England Journal of Entrepreneurship
College of Business
Sacred Heart University
5151 Park Avenue
Fairfield, CT 06825-1000
(203) 371-7854 (phone)
(203) 365-7538 (fax)

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Sample Copies

Sample copies of the previous issues will be available from the Editor on a first-come, first-served basis.

New England Journal of Entrepreneurship

From the Editors

We are pleased to announce that Dr. Gary Castrogiovanni, Professor of Management at the University of Tulsa, Tulsa, Oklahoma, has received the second annual Best Reviewer Award from this journal. Gary's tireless efforts on behalf of the *NEJE* have been ongoing for the past six years. We appreciate his dedication to our publication and to the field of academic research in entrepreneurship.

As is typical of our (still young) journal, we offer diverse reading material for your interest. We begin with two interviews of entrepreneurs in very different arenas: one is just getting started in the importation of fine European glassware, while the other has six years under his belt as a niche player within the telecommunications field. Both entrepreneurs exemplify the kind of person who excels as his/her own boss: they are driven self-motivators who constantly strive to grow their business and get better every day.

We follow with two refereed articles and a refereed case study. Should you wish to obtain the instructor's manual for the case, please contact the authors directly; this information is provided at the end of the case study.

As is now common practice, Joe Levangie, of our editorial staff, has conjured up another arresting piece on the types of things entrepreneurs must do well in order to succeed. We believe that we best serve our readers by providing a mix of academic, as well as practitioner, points-of-view in the *Journal.*

Finally, we announced in our last issue a special issue for spring 2005 on "Measurement Issues in Entrepreneurship" under the Guest Editor leadership of Dr. Jill Kickul of the Simmons School of Management. It looks like the special issue will appear in Fall 2005.

The *Journal's* editorial staff continues to welcome your comments and reactions to our bi-annual publication wherein we provide a forum for the best manuscripts we receive from our international audience.

Dr. Laurence Weinstein	Dr. Joshua Shuart	Christopher Sheehan	Joseph Levangie
Editor	Associate Editor	Associate Editor	Associate Editor

Juliska: Filling a Niche with Imports

David Gooding, CEO
Juliska, Inc.

David and Capucine Gooding are completing their third year in business, directing the growing activities of their import business located in Stamford, Connecticut. Their niche is marketing handblown glass which is historically accurate and inspired by such disparate designs as 14th-century French, 16th-century Dutch, and 19th-century Venetian glassware. We interviewed David on a "quiet" day when the phones didn't seem to be ringing constantly.

NEJE: Starting an import business from "scratch" requires a remarkable energy level. What prepared you for this work?

Gooding: I grew up near London with a father who had a thriving import business bringing in high-end tableware from the European continent. He sold these goods to British retailers who could appreciate the quality of the imports and find the right audience for them. I worked my way up in the company starting from the warehouse and ending up selling my family's product line to the finest upscale clients we had at the time.

NEJE: Why not stay in England and build on that success?

Gooding: I could have, I suppose, but becoming an entrepreneur in America intrigued me. I decided to attend college in the States to learn more about life in the United States. I'd been inspired by the "sky's-the -limit" thinking here—compared to Europe where the business culture is less daring, the taxes are considerably higher, and the chance to become wealthy is much more difficult.

NEJE: So your story began once you graduated college?

Gooding: In a way, yes. I graduated from Hobart College in 1993. That experience gave me plenty of things to say at cocktail parties, but it didn't have any specific application to my future life as an entrepreneur. I got a position with MacKenzie - Childs, a high-end tableware company located in the States, and stayed with them for one year traveling around the country making connections with buyers from such stores as Neiman-Marcus and Bergdorf Goodman. This was important because it would later lay the foundation for me to go to these same stores and sell them my own line of goods.

NEJE: Is that when you went on your own?

Gooding: I quit MacKenzie and felt at age 24 that I needed to venture out on my own. Call it hubris, but coming from an entrepreneurial family, I felt I was ready.

NEJE: Were you?

Gooding: Yes and no. Yes, because I was able to pick up several European tableware lines as their commissioned sales representative in the United States after attending trade fairs in Paris, London and Italy. I asked for, and received, exclusive rights to represent these companies for five years. Imagine, at age 24, with little personal business experience of my own, talking to executives from corporations and individual artisans throughout Europe and convincing them to trust me!

I am absolutely at heart a salesperson through and through. The thrill of the hunt, so to speak, drives me constantly. I won't take "no" for an answer so at a tender age, there I was representing these upscale manufacturers to U.S. retailers.

NEJE: However, getting to the "no" part of your "yes and no" answer means?

Gooding: Every retailer I went to loved the goods I had to offer. They gave me substantial orders and I believed I was on my way. However, the tough part came when the retailers attempted to turn around and sell this merchandise to the end customer. The prices the retailers sought were so high that buyers balked. The inventory sat, and while it sat, I couldn't sell in more product. I spent five years under the banner of "Penshurst Trading" trying as hard as I could to work with these retailers and increase their product turnover, but to no avail.

Those five years, though, gave me a great opportunity to really learn the American market. I have traveled to every major retail city in the States, as well to outlying suburbs, and got to know hundreds of key retail buyers. Importantly, I also got to learn what the American consumer was looking for; what they'll buy and what they won't. That knowledge proved to be invaluable.

NEJE: You were close to 30 years old at that point, treading water and…?

Gooding: I needed to find a product line where the perceived value was better, the prices certainly lower, and the product story stronger in order to succeed in the United States.

Capucine had the good fortune of working a Paris trade fair in 2000. She had been employed by Martha Stewart with one of her enterprises called the Wedding List. My wife has a keen fashion eye and came across a booth where a husband and wife team, the Bollens, were representing a cooperative of Czech glass blowers who all lived near Prague. They had only 40 pieces to show, but the product was dazzling. Capucine was blown away, as it were, by the merchandise.

I happened to be with Capucine in Paris during the trade fair and we immediately began negotiations with Juliska Bollen about taking over their sales in the United States. At the time, they were only generating revenue of roughly $100,000 annually in America among just 10 retailers, but they were content with that. They believed the market was saturated. We saw much more potential and offered them $100,000 for the right to deal directly with the glass blowers, design our own collections, and sell exclusively in the U.S. market.

NEJE: What happened next?

Gooding: I went to Prague and had to convince these Old World, very talented people that I was a long-term player who was going to build a large and reliable source of orders for them. I had convinced the Bollens, but selling myself to the glass blowers was a whole different experience. I said that, under my sales leadership and with my wife designing goods for the American marketplace, we could expand their product line from 40 items to 400 within three years.

And we've done it.

NEJE: It's one thing to have a vision and promise to deliver, quite another to accomplish what you set out to do.

Gooding: Tell me about it. Life over the past three years has been incredibly hectic, but it has also been incredibly fulfilling. The most important decision we had to make was our market positioning with the glassware. We decided to name the product line after Mrs. Bollen because her first name, Juliska, was elegant sounding and we wanted to honor her for initially finding the Czech artisans and culling their product line for the Paris show.

Each piece is signed with the Juliska brand name and we sell only to premium-priced retailers like Neiman-Marcus. We absolutely will not sell to anyone, such as Macy's or Bloomingdale's, who are known to discount their product prices. Our positioning is clear: The product is truly unusual, fills a consumer need, and is priced a bit below existing competitive products to give Juliska an edge in terms of perceived price/value benefit. We strive and strive for quality. We currently destroy 40 percent of what the Czech cooperative sends us because we believe it isn't up to our standards. We expect that figure to decrease substantially over the years as the glass blowers and we get used to doing business together. But we absolutely will not ship any product that does not pass our strict quality-control oversight.

NEJE: What are your end-consumer demographics?

Gooding: Young brides, certainly, but we like to think we also appeal to practical people with great taste. These are more creative buyers, usually women, who are looking for something different, something new. They love antiques and want things in their homes that have a certain Old World, European charm to them. Age as a demographic seems to be irrelevant; it is the taste level that creates a commonality among our retailers' customers. They're not looking for something precious; they're looking for beauty and functionality at the same time.

Our slogan for Juliska is, "Quite possibly the most beautiful glass in the world." I got the inspiration for that tag line from seeing Carlsberg Beer commercials. The brewery boasted it offered "quite possibly the best lager in the world." Well, if they could do that for beer, we could do it for glass! When prospective buyers see our goods at retail, they anticipate finding a price point comparable to say, Waterford Crystal. We surprise them by using a penetration price level of roughly 30 percent less than competitive product. That closes the sale—beauty and function at a very fair price.

NEJE: Looking over your product catalog, the effort to establish Juliska in the United States that you and your wife have accomplished is certainly impressive, but it must be exhausting and anxiety-producing. Your capital is constantly at risk and there is no guarantee you'll ultimately be successful.

Gooding: Can't argue with you on that score, but let's look at it from our point of view. There are nearly 300 million people living in the United States. Discretionary income is huge. I came to this country with the aspiration to be a success and we've found a great niche to sell in. I have no family money in this business, but I do have a great relationship with several local banks.

We've increased our revenues by almost 2500 percent in three years. By the end of this calendar year, I estimate our receipts will be more than $2.2 million, and we've just received our first substantial order from Neiman-Marcus. Next year, for 2005, I hope to ship more than $3 million in product. We are carried in 600 to 700 stores across the country, with 90 percent of that total, small independent stores where the proprietor's name is on the front of the door. These owners take great pride in what they sell and their image is tied in with every item that goes out the door. That's what makes our company's emphasis on quality and strictly holding the line on price so vital to continuing to do business with them.

I can anticipate your next question, so I'll answer it for you. Have we shown a decent profit yet? No. When you cut your margins to the bone, profit generation is put off until you achieve a certain momentum in the marketplace. We intend to reach that level soon.

Do we still borrow from friends and use our business lines with the banks to support our rapid growth curve? Yes.

My personal goal is to either have sales of $10 million annually by the year 2010 or else get bought out by someone for $10 million by then. I want to live the good life, and either way, in another five years or so I expect to have earned it.

NEJE: During our discussion today, you've never mentioned something very dear to the hearts of marketers—the use of market research to confirm their observations about what customers want. How come?

Gooding: I didn't need to underwrite market research. With our funds so stretched as it was, my wife and I, with design help from one of our employees, Elaine McCleary, have taken care of every significant decision and detail the business has required. We have used an outside photographer for our product shots, but other than that, we have designed everything, done all the traveling to the Czech Republic, arranged all the importing, created our own advertising and placed the media buys. We look for publicity constantly and send out our own publicity pieces every day to the top magazines in the field including *Food & Wine, Metro Home, El Décor, House Beautiful* and *Town & Country*. We constantly get asked for product samples to include in their content articles and all we ask for is product credits. The magazine editors love our product line and we get orders based on retailers seeing our goods in the magazines.

NEJE: How long can you keep up this pace?

Gooding: As long as I need to. I don't like to be told by anyone that I can't do something. I don't need or yearn for anyone else's approval, nor do I need a pat on the back. What I do need is to build something concrete, something I can look back and say with pride, that I built that business. I'm driven to create and invent every day. I love the buzz of orders coming in and I enjoy working in this industry. Working with creative people like my wife, and with Elaine, working with creative retailers to build their businesses and others, this isn't work—it's fun.

I also want to make a lot of money.

NEJE: How do you cope with the anxiety of running a growing, dynamic business?

Gooding: I don't think of the issues that arise at work as ways to generate some internal type of worry or anxiety. I see everything that happens as an opportunity. Selling is in my blood so I sell like crazy. There's always a way to get to "yes" and to have people see dealing with Juliska as a "win-win" situation. If I were still in Europe, there'd be too many factors out of my control. The government, local and European Union laws, taxes, business restrictions—I'd go out of my mind. In the United States, there is so much more potential for businesspeople who care and are thoughtful in how they approach their business. The problem is, people don't care enough to spend the time and effort to make their businesses succeed.

The other thing that's quite important to me is integrity. We honor all of our commitments. We have solid relationships with our retail accounts and they appreciate how hard we work on providing the best customer service we can. We've just added our sixth employee, Anne, whose job it is to keep in touch with our 50 commissioned sales representatives in the field as well as our retail accounts.

I'm learning to delegate some of my work, but the one thing I won't delegate is any part of the sales contacts we need to keep up. Sales represent our revenue stream and no entrepreneur who wishes to be successful should ever delegate that work even if you have a sales manager. You can spend a day a week strategizing, but the other four days the owner must be totally involved in the business. Relationships are fragile and that's why I will always be the one making sure our retail relationships stay strong.

NEJE: Do you anticipate any threats to your strong growth curve?

Gooding: I suppose at some point we can expect to see knock-offs of our product line entering the distribution chain, but I can't see another company matching our quality at the price points we have established.

We might need a full-time CFO at some point to guide our financials. If we don't select someone very good, I imagine our bottom line could be affected. That is something we need to think about within the next year.

It's also hard to put a lid on expenses when business is growing so fast. I try hard to do that, but it isn't always easy.

There's also no model for success that I can pull off the shelf and use as a guide everyday. Something new comes up and I have to use my existing skill set to solve the problem and create a new opportunity for us. I've just joined a group of entrepreneurs who meet once a month to bounce ideas off one another. I sure wish I had found this group earlier; I could have avoided some costly mistakes. It's not exactly lonely at the top, but it sure can be frustrating not to have someone to listen to your ideas and give you feedback about whether it makes sense or not. Having a sounding board is invaluable.

NEJE: What if you ever got sick? Do you have any contingency plans in place for such an emergency?
Gooding: I don't plan on getting sick. With such a small staff, we don't have the luxury of fielding a contingency plan, at least not for the moment.

NEJE: What are some words to describe who you are?
Gooding: I would say driven, ambitious, passionate, enthusiastic, impulsive, honest, risk-taker, an outside-the-box thinker, someone who enjoys empowering others and watching them succeed, and enthusiastic. I don't want to spend my time thinking or dwelling on the downside. I get real enjoyment out of putting together a creative team and watching them come up with great solutions. I'm a leader, but I certainly don't need to get all the credit for being successful. Success is a team effort.

—L.W.

The Values of Being Small and Nimble

Peter Christian Murphy

Peter Christian (Chris) Murphy had worked his way up the "food chain" at AT&T for 19 years, culminating in his position as Sales Center Vice President for South Florida. When he and a coworker realized there was an opportunity in the marketplace for a small, nimble company to take advantage of emerging communications technology that a stodgy, lumbering corporation would have trouble integrating into its service package, Chris decided to jump into an entrepreneurial opportunity.

NEJE: What is your new venture called and what are your roles in it?

Murphy: The company is called Global Linking Solutions, or GLS. We're a managed network and security provider and I'm the president and COO. We're a small company so I get to do a little bit of everything. An important part of my responsibilities is focusing on setting the strategic direction for GLS. That means developing and shaping a sound business plan and constantly adjusting to the ever-changing marketplace.

I also get to work in a number of tactical areas such as sales, financial operations, marketing, engineering, product development, systems development, process engineering, staffing, and even cleaning up after our Friday staff lunch.

My partner and I started this company from scratch in 1999 and now we have about 50 employees. All of our systems have been built internally and I am part of the team that guides the development of our tools and processes, which in a service business means you're going "24/7."

NEJE: What was the path you took to get you where you are today?

Murphy: I was working for AT&T in South Florida when I met Michael Scanlon. Mike supported my team as the Data Technical Manager and he helped my group win some very significant accounts. Mike and I both felt there was a big need in the marketplace for someone who could do a good job of building networks for clients. Most of the integrators and solutions-providers looked at the wide area network as just an add-on to their regular business and they weren't very good at designing and implementing the wide area network. The carriers didn't understand customer solutions and were not very skilled in implementing networking and security equipment.

Mike and I decided to build a company that would design and build data networks and we were going to do it better than anyone else. We had had a high success rate within AT&T, but we knew there were constraints on what we could offer and how fast we could deliver on client needs.

In 1999, Mike and I left AT&T determined to build our own company and make it more nimble and responsive to client requirements.

NEJE: What did you do for capital?

Murphy: We developed a strong business plan and started to look for funding. Fortunately, we didn't have to look very far. Mike's dad, Jack Scanlon, already well known as a leader in the telecommunications industry, decided to fund our start-up company and we were literally off to the races.

We started to implement our business plan in July 1999. One of our first moves was to hire away four other AT&T executives so we could start attacking the marketplace aggressively. Lucky for us we didn't know what we could or couldn't do! We were confident we had identified an important market niche. GLS won some pretty big accounts right away.

NEJE: Was it a case of beginner's luck?

Murphy: No, we had put together the right mix of service products and people to make a go of it long term. Howwever, we realized after a year in business that the service mix we provided, especially if we sold a carrier-only deal, was becoming commoditized. That meant that GLS was not "sticky" enough. There was no reason for our clients to remain loyal to us. We knew we would have to do something different in the data networking market—something value added—so that we would become more important and differentiated from our competitors.

We decided to seek additional funding to build a Network Operations Center that would allow us to offer a suite of managed network and security services. In October 2000, we launched three new offerings: Managed Frame Relay, Managed Virtual Private Networks (VPN) and Managed Firewall.

Slowly, but surely, we started to gain new clients and hold on to our existing ones.

NEJE: Who are your main competitors?

Murphy: GLS is a small, managed wide area network provider; this means we have two different sets of competitors. First, we compete against the likes of AT&T, Qwest, MCI, and the Bell operating companies in the Managed

Frame Relay and VPN market segments. Those are the "big guns." In the VPN arena, there is another group of specialized and smaller companies that we compete against including Netifice, Clearpath, Virtella, Megapath, and Aubeta.

NEJE: And then there's tiny GLS.

Murphy: Exactly. For a small company to succeed, you must clearly distinguish yourself from everyone else. GLS differentiates itself against the high-end companies, like AT&T, with managed offers that match up well on a feature-functionality basis, but at a much more reasonable price. Since we are a much smaller company than an AT&T, we can also be more flexible. Customers are very appreciative when solutions are custom tailored to their needs rather than taken "off the shelf." Our customers also like the fact that they are important to us and have easy access to everyone who works for GLS. That sure beats sitting on hold and getting the runaround at one of the big customer care bureaucracies.

In the VPN arena, we compete with a bunch of niche VPN providers. They have all invested in building their networks to deliver VPN capabilities at reasonable prices. We find we are usually very similar in pricing to these niche folks and sometimes their offerings even approach GLS on feature-functionality.

NEJE: So it's harder to make yourself seem different and better.

Murphy: The difference between us and the other VPN players is we are also trying to manage a private network to deliver service. These small companies have to use their best resources looking internally at their own network infrastructures and not on their customers.

Additionally, when GLS builds a network, we use top-quality research components from the leading DSL business customers, such as Covad, New Edge, and the Bell Companies. Since we use only the best (and most expensive) network components, the diversity, redundancy, and reliability with a GLS VPN network will always be far superior to those competitors of ours who cannot afford, or do not choose, to use these best-in-class components.

We don't own the network and none of the traffic is dependent on GLS infrastructure, so the client doesn't have to worry about our solvency as a company. If there were concerns or fears about our corporate solvency, that could put the client's entire network at risk. Literally, if we owned the network and stopped functioning, the customer's network could vanish. That's critical, because several of our closest competitors appear to be losing money with their business model while GLS has turned a profit each of the last three years.

NEJE: Even with these advantages, was there one day when you knew you had broken through the competitive "clutter" and you were on your way?

Murphy: Yes! Our big break came in early 2001 when we sold a fully managed DSL VPN to Domino's Pizza. At that time, I don't think you could have found a DSL VPN, so we had an early position as the market leader. As one might expect, we learned lots of lessons with our Domino's client, and that's truly the case when you are pioneering a new market segment. DSL VPN has been a great boon for our company and we continue today to manage some very large retailers. We now have DSL providers working with us to deliver our managed VPN services over their own DSL circuits.

Our managed services business has grown, GLS became profitable in 2002 and continues to be profitable today. In October 2003, GLS self-funded a move to a new 15,000-square-foot facility, which includes a diesel generator to protect against black- and brown-outs, an OC48 ring, and new furniture and computers for our NOC. We continue to add new tools and we have rolled out a whole new suite of managed servers and security products. It seems like we have come a long way, but I feel we are just getting started. In 2005, we will begin offering our services to the federal government, having just been approved by the GSA.

NEJE: That's all very impressive. Are there certain people or events in your life that you can look back to and credit with helping you become so successful?

Murphy: I was about nine years old when I went to this cowboy camp with a friend of mine. We had a lot of fun riding horses and doing cowboy "stuff." Well, what I didn't know was this was a Christian cowboy camp and we were required to go to church every night. Anyway, I was away from home for the first time in my life and I guess I was a little lonely and homesick. They had a preacher there and he introduced me to this carpenter who has watched over me and guided me ever since. I may have ignored Him and His advice for periods of my life, but I strive to work for Him and for my family.

NEJE: What was the biggest break you ever got before starting GLS?

Murphy: I guess it was when AT&T promoted me to run the South Florida operation. I got to live at the beach in Fort Lauderdale for seven years and gain some great work experience that prepared me for entering the entrepreneurial world.

NEJE: Would you say you also had great disappointments?

Murphy: I wish I had become an entrepreneur much earlier in life. Not only have I learned so much about business and life every day, but also, I would have earned millions if we had started GLS during the "dot com" boom.

NEJE: What impact did your education have on your success?

Murphy: I was not academically inclined and actually took 18 months off from college to mature some before graduating from Ramapo College in New Jersey. I joined AT&T right out of college as a sales representative and they put me through three months of training where they taught me about sales. As you might expect, I learned a whole lot of stuff that really wasn't all that important. I think that everything I have learned of any lasting importance, I learned on the job. You have to experiment with ideas that you think will work, you have to try and make them work and then rework them and try again.

When an idea works the way you want it to work, you have to make sure you are getting the most mileage out of that idea. If one of your ideas doesn't appear to be successful, and you have tried to rework it a few times, you need to quit trying to fix it and spend time on things that are working or begin to implement new ideas.

NEJE: Is there anything you would change in your life if you could go back in time?

Murphy: As a said earlier, I would have become my own boss much sooner. In fact, I should have been an entrepreneur right after college. While I learned a lot working for "Mr. Big," I think I could have learned a lot more and a lot faster enrolled in the "entrepreneurial school of hard knocks."

NEJE: How about some of the jobs you had growing up and how they shaped you as a person?

Murphy: My first job was actually an entrepreneurial position as a clam digger on Long Beach Island. I was 13 years old and I had a 14-foot aluminum boat that I would take out and clam for four or five hours, then sell the clams I dug up at the fish market for two cents apiece.

My life lesson from that job was to concentrate on the work at hand and not to let sharks scare you! I also had a job as a kid running the bumper cars at an amusement park, running an ice cream parlor, and I was even the head chef for a time at a gourmet restaurant. I learned how to lead a team, how important it is for everyone to feel empowered in a team, and how crucial it is to find an efficient process and then stick with it.

I also made a lot of friends at work and always tried to have fun even when there was pressure. Matter of fact, the more pressure on us, the more fun we had and it's the same way today.

NEJE: What was your family upbringing like?

Murphy: I was adopted as a baby by two loving parents. I was taught to be honest, help those less fortunate than me, and to work hard. I was also taught to have fun when I worked because work without fun is just a burden.

NEJE: Where do you see yourself going in the future?

Murphy: When I was part of the corporate world, I always thought about when I would no longer have to work. I haven't really considered my long-range plans, but I will be open to going wherever the Lord leads me. Am I content with my job? Well, I have a great job now because I get to do a little of everything and I am always learning. I am continually challenged and I work with a great group of people. I use the word "content" because I think we should always be able to do things quicker and better. I will say that I do enjoy my work and I feel blessed.

NEJE: What's in store for GLS?

Murphy: I see GLS really growing into a significant company in the not-too-distant future. We are in a growing field, especially where network security is concerned. That growth curve should continue to expand significantly during the next decade. As long as we continue to provide innovative, managed solutions that solve real problems, and offer tremendous value, we will be the kind of company that sneaks up and surprises people.

—J.S.

Doing Well and Happy About It? Explaining Variance in Entrepreneurs' Stated Satisfaction with Performance

Gregory B. Murphy
Stephen K. Callaway

The importance of performance measurement is largely undisputed. There is debate, however, regarding the equivalency of objective and subjective performance measures. This debate has not considered a frequently used subjective measure, satisfaction with performance, to be an important measure independent of its equivalency with objective measures. Using a sample of 368 manufacturing firms, this study found that objective measures explained only a modest amount of variance in satisfaction with performance and that other variables added significantly to the explained variance. These factors included perceived environmental hostility, vulnerability, perceived competitive advantage, and commitment.

An abundance of research has addressed the importance of entrepreneurial performance. The consequences of entrepreneurial performance are important to society at large (Kirchoff and Phillips 1988) and to individual entrepreneurs and their associates (Cooper 1993). Therefore, understanding entrepreneurial performance and its measurement are critical issues (Chandler and Hanks 1993; Murphy et al. 1996). Kanter and Brinkerhoff (1981) argue that performance measurement issues are fundamental to understanding organizations and that what is measured is as important as how it is measured.

This article seeks to contribute to the literature by focusing on satisfaction with performance, a seldom studied, yet important aspect of entrepreneurial performance (Cooper and Artz 1995). This research contributes to the existing literature in two important ways. First, considerable debate exists in the entrepreneurship literature regarding the equivalency of objective and subjective measures of performance. Satisfaction with aspects of entrepreneurial performance in particular have been proposed and used as objective measure surrogates (Covin and Covin 1990; Covin and Slevin, 1990; Covin et al. 1990; Gupta and Govindarajan 1984; Naman and Slevin 1993). Therefore, one objective of this study is to offer insight as to the equivalency of satisfaction with performance with relatively more objective, parallel measures of entrepreneurial performance. Second, satisfaction with performance is an important measure of entrepreneurial performance in its own right (Cooper and Artz 1995), independent of its equivalency, or lack of equivalency, with more objective measures. Satisfaction with performance, or the lack thereof, likely impacts important investment and continuance decisions by the entrepreneur (Cooper and Artz 1995). In this sense, satisfaction with performance in the short term may likely lead to the more objective measures of performance in the long term. The second objective of this article then, is to investigate factors that likely explain variance in satisfaction with performance.

Objective and Subjective Measures

Obtaining objective performance data for entrepreneurial firms is a difficult task because private firms are typically not required to disclose their financial position and have little incentive to do so (Dess and Robinson 1984; Sapienza et al. 1988). As a result, secondary data sources rarely include in-depth performance information on entrepreneurial firms. The issue is further complicated by the fact that asking for sensitive or difficult information on surveys may reduce response rates (Dillman et al. 1993), making primary data gathering more difficult. To overcome these liabilities, many researchers have suggested the use of subjective performance measures as an acceptable alternative to using objective performance measures (Dess and Robinson 1984; Gupta and Govindarajan 1984). The equivalency and appropriateness of using subjective measures, as opposed to objective measures, has been debated in the academic literature in general and in the entrepreneurship literature in particular.

Two particular articles have strongly encouraged the use of subjective measures as surrogates for objective measures of performance. Dess and Robinson (1984) argued that in the absence of objective data, an accurate assessment of firm performance could be obtained by asking respondents to subjectively compare the performance of their firm to the performance of immediate competitors. Gupta and Govindarajan (1984) provided an alternative approach, arguing that firm performance could be subjectively inferred by considering respondents' stated importance of and satisfaction with a variety of performance measures. Support for the relevance of subjective measures is usually based on correlation analysis. For example, Dess and Robinson (1984), found self-reported sales levels and average return on assets to be positively correlated with subjective assessments of sales and average return on assets respectively for their sample of 26 firms in the paint and allied products industry. In researching joint ventures, Geringer and Hebert (1991) and Glaister and Buckley (1998) found objective and subjective performance measures to be positively correlated.

However, other studies have not supported the proposed equivalency of subjective and objective measures (Chandler and Hanks 1993; Deeds et al. 1998; Sapienza et al. 1988). Sapienza et al. (1988) attempted to replicate Dess and Robinson's results, but were unable to do so. Although Sapienza et al.'s study also had a small sample size (34), they found no significant correlations between objective measures of performance (sales growth and return on sales) and their proposed subjective equivalents. Arguably the most in-depth study on the equivalency of objective and subjective measures was conducted by Chandler and Hanks (1993). Based on a sample of 120 firms from varied manufacturing industries, the authors assessed the relevance, availability, reliability, and validity of performance measures (growth and business volume) gained by asking respondents to: (1) indicate their performance in broad categories; (2) complete a weighted satisfaction with a performance index similar to that introduced by Gupta and Govindarajan; and (3) indicate, using a Likert-type scale, their perceived performance relative to competitors (similar to Dess and Robinson 1984; Sapienza et al. 1988). Their study found strong positive correlations between self-reported growth and volume in broad categories and two subjective measures, performance relative to competitors and the satisfaction with performance index. Chandler and Hanks concluded, however, that satisfaction with performance is particularly suspect as an equivalent performance measure since its relevance is unknown and external validity was found to be inadequate. External validity was listed as a concern because independent variables previously found to impact new venture performance had little effect on the satisfaction with performance measure.

Investigations into the equivalency of subjective measures in both the organizational behavior and marketing literatures have produced similar results. In the organizational behavior literature, Bommer et al. (1995) conducted a meta-analysis and found a .389 correlation between objective (direct measures of countable behaviors) and subjective measures (supervisor ratings of performance). The authors concluded that while significantly correlated, the measures are not enough so to be used interchangeably. Likewise, in the marketing literature, Dawes (1999) found that while objective measures (ROI and ROA) were strongly correlated with subjective measures (measured by "Please rate the performance of your company as . . . 1=terrible to 11=absolutely outstanding"), the correlation (.48) was far from perfect. Combined, the literature seems to suggest that while objective and subjective measures are correlated, they clearly are not the same thing.

Therefore, the current study consistent with Bommer et al. (1995) and Dawes (1999), takes the position that objective and subjective performance measures, while positively correlated, should still be considered separate constructs.

H1: Objective and subjective measures of performance will be positively correlated.

H2: When factor analyzed, objective and subjective measures of performance will load on separate factors.

Satisfaction with Performance

Studying objective performance measures has the important advantage of facilitating performance comparisons across firms. This desire for comparability, combined with the previously mentioned difficulties in obtaining objective performance data on entrepreneurial firms, may have contributed to the search for objective performance equivalents. Of particular interest to this study, however, is to explain and understand the concept of satisfaction with performance itself.

Although frequently used as a potential surrogate for objective performance, satisfaction with performance is an important variable of interest in its own right (Cooper and Artz 1995). The stakeholder approach to performance measurement contends that organizations are successful to the extent that important stakeholders' interests are satisfied. Arguably the most important stakeholder of an entrepreneurial firm is the company owner. Cooper and Artz (1995: 440) call entrepreneurial satisfaction[1] a "fundamental measure of success for the individual entrepreneur" and note that it may impact critical investment and continuance decisions. Satisfaction has been linked to voluntary job turnover in the organizational behavior literature (DeConinck and Bachmann 1994; Griffin and Batemann 1986; Mathieu and Zajac 1990; Parnell and Crandall 2003; among others). Although seldom studied in the entrepreneurship literature (Cooper and Artz 1995), the consequences of satisfaction are likely much greater for a business owner than for employees in large organizations. As a result, understanding what drives this satisfaction is critical.

Therefore, the current study takes the position that factors other than actual growth and profitability (objective performance) will explain satisfaction with performance. These factors include perceived environmental hostility, vulnerability, perceived competitive advantage, and commitment. The model is shown in Figure 1.

Environmental Hostility

Satisfaction with performance may vary with the entrepreneur's perceived environmental hostility. Hostile environments are those that are risky as a result of intense competi-

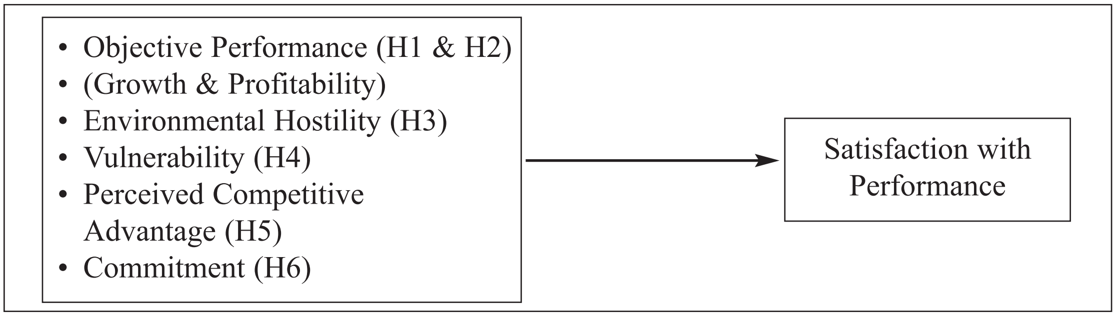

Figure 1. Model of Factors Predicted to Affect Satisfaction with Performance

tion that is largely, if not entirely, beyond the control of the firm (McGee and Rubach 1996). Entrepreneurs perceiving a very hostile environment may be satisfied with lower performance levels, believing that firm performance could be much worse given the environment. Others may feel that higher performance levels are needed to compensate the entrepreneur for the increased risk of operating in a hostile environment. In either case, satisfaction with performance would be affected by perceived environmental hostility.

H3: Controlling for objective performance, environmental hostility will explain additional variance in satisfaction with performance.

Vulnerability

While perceived risk is largely a function of perceived mar0ket characteristics, internal firm factors—such as financial leverage and liquidity—may greatly affect the entrepreneur's vulnerability to external market characteristics. Greater debt levels and lower liquidity significantly increase the likelihood of bankruptcy and financial ruin for the entrepreneur. Such vulnerability should cause entrepreneurs to expect greater, compensating performance levels to maintain an appropriate risk-reward balance. Entrepreneurs expecting greater performance levels should be less satisfied with a given level of performance than entrepreneurs with lower expectations.

Apart from the increased vulnerability to bankruptcy, high debt levels and low liquidity place considerable pressure on firm operations and cash flow. As organizational slack is reduced, organizational stress is likely increased. Relatively small mistakes and inefficiencies have the potential to cause considerable harm to the venture and subsequently to the entrepreneur when organizational slack is minimal. This stress, combined with the greater likelihood of bankruptcy, may significantly impact the entrepreneur's stated satisfaction with performance. Given such a circumstance, good performance may not be good enough.

H4: Controlling for objective performance, vulnerability will explain additional variance in satisfaction with performance.

Perceived Competitive Advantage

Entrepreneurs may be more satisfied with the performance of their firms if they believe they enjoy a strong competitive position in the marketplace. In this study we consider three perspectives likely to impact perceived competitive advantage: perceived resource advantage, perceived advantage of generic strategies, and self-assessed competencies.

The resource-based view of the firm argues that firms are more likely to earn and sustain long-term profitability if they own or control resources that are valuable, rare, difficult to imitate, and efficiently used (Barney 1991). Entrepreneurs who believe that their resource base fits these characteristics should, as a result, also believe that their long-term potential in the marketplace is strong; thereby enhancing their satisfaction with performance.

In the entrepreneurship literature, research on new venture performance has found that generic firm-level strategies significantly affect firm performance (McDougall 1987; Sandberg and Hofer 1987). Entrepreneurs believing their firms enjoy a relative competitive advantage, such as lower costs, loyal customers, superior product quality, etc., should also believe that the potential for sustained long-term success is enhanced, thereby enhancing their satisfaction with performance.

Entrepreneurs who believe they possess personal competencies shown to enhance the probability of long-term success should also believe their likelihood of long-term success is greater and thereby express greater satisfaction with performance. Chandler and Jansen (1992) found self-assessed competencies to be significantly related to performance. Entrepreneurs, for example, who believe that they possess strong abilities to identify emerging market opportunities, to efficiently organize business operations, and to gather needed support for the venture should also believe that their long-term potential for success is significant. If nothing else, the optimism and positive orientation often associated with higher self-evaluations should also be associated with higher stated satisfaction with performance.

H5: Controlling for objective performance, perceived competitive advantage will explain additional variance in satisfaction with performance.

Commitment

Commitment to the venture may impact satisfaction with performance. Dyer (1992) noted that entrepreneurs vary greatly in their level of commitment to their businesses. Differences in commitment levels may cause entrepreneurs to require different levels of profitability for entrepreneurs to be satisfied with the same. Although there are many facets and measures of commitment, we will examine emotional commitment, education level, and committed resources as indicators of commitment in this study.

Entrepreneurs expressing strong emotional ties to a business may be more satisfied with a given level of performance. Emotionally committed entrepreneurs may be less likely to sell or close their businesses regardless of firm performance. In the organizational behavior literature, organizational commitment, defined as an individual's identification with and involvement in an organization (Steers 1977), has been found to significantly and negatively affect voluntary job turnover (Mathieu and Zajac 1990). This persistence, sometimes referred to as continuance commitment, is a recognized part of emotional or attitudinal commitment (Mathieu and Zajac 1990). Entrepreneurs with less commitment to a specific business may focus more on opportunity costs, causing them to consider more critically the performance of their present venture(s). Such opportunity costs, however, are likely much less of a focus for highly committed entrepreneurs as they invest less time and energy in the identification and assessment of possible alternatives to the existing venture(s). Another, more direct reason why emotional or affective commitment may impact satisfaction with performance is that such commitment has been found to be positively correlated with job performance in the organizational behavior literature (Riketta 2002). If affective commitment leads to improved job performance by entrepreneurs, and if that, in turn, leads to better firm performance, one would expect affective commitment to affect satisfaction with performance.

Cooper et al. (1994) predicted and found that education level contributed to both marginal survival and high growth. The authors concluded that educational attainment may "reflect certain qualities of 'stick-to-it-ness' through a combination of commitment, motivation, and discipline" (p. 389). Since high performance and satisfaction with performance are likely related, one would predict that education level should be positively related to satisfaction with performance. The relationship between education level and satisfaction with performance is not likely so clear however. As Cooper et al. (1994: 376) also noted, "It may be that more educated entrepreneurs perceive a higher opportunity cost in staying with a marginal business. This could lead to a higher level of performance in order to stay with a venture…" While the preponderance of evidence indicates that education level contributes positively to firm performance, better educated entrepreneurs may expect better performance and not be as satisfied with a given level of performance as a result.

Total resources committed to a business may also be an indication of entrepreneurial commitment. Arguably, entrepreneurs who commit more resources are likely to be more committed to their businesses. Cooper et al. (1994) found the amount of initial financial capital raised to be positively associated with the probabilities of marginal survival and growth. McCarthy (1992) also found initial capital to be positively related to new venture performance. While the preponderance of the literature has shown a positive relationship between initial capital and performance (Cooper et al. 1994), the relationship between committed resources and satisfaction with performance may be analogous to the relationship between education level and satisfaction with performance. Having committed more resources, an entrepreneur would require greater profits to earn the same rate of return on his or her investment. As a result, entrepreneurs who commit more resources may be less satisfied with the same level of profitability than entrepreneurs who commit fewer resources.

H6: Controlling for objective performance, commitment will explain additional variance in satisfaction with performance.

Sample and Measures

Sample

Data were gathered from a sample of new and/or small manufacturing businesses located in Harris County, Texas. The industries selected were: SIC code 27, printing and allied industries; SIC code 28, chemicals and allied products; SIC code 30, rubber and plastic manufactured products; SIC code 34, metal fabricating; SIC code 35, machinery manufacturing; SIC code 36, electrical and electronic products manufacturing; and SIC code 38, measuring, analyzing, and controlling instruments. Sampling only manufacturing firms reduced interindustry effects. All of the firms were listed in the *Dun & Bradstreet Regional Directory-Houston, the Directory of Texas Manufacturers,* or the State of Texas Sales Tax Files. Firms were eligible for sample inclusion if (1) they were located in Harris County, (2) they were privately and independently owned, and (3) they were less than five years old, or they had fewer than 500 employees. Approximately an equal number of firms from each industry group were selected from each of the three sample sources.

Data Gathering

The Dillman (1978) approach to survey design and mail-out procedures was used as a guide in this study. Two full mail-outs and a post card reminder were conducted. Of the 1,889 firms that were mailed a survey, 109 were returned as undeliverable and could not be contacted by telephone, 34 of the businesses indicated an established policy of not participating in studies, 23 of the businesses were found to be actually located outside Harris County, 16 of the businesses were no longer in operation, 10 businesses were discovered to be subsidiaries of larger corporations, and 1 firm failed to meet the preestablished criterion of having less than 500 employees or being less than five years old. Of the 1,696 firms eligible to respond, usable responses were returned by 368 of the businesses, yielding a 21.7 percent response rate.

Tests for Possible Response Bias

Two tests for possible response bias were conducted. First, using only the data provided in the sample source (i.e., *Dun & Bradstreet, Directory of Texas Manufacturing,* and the Texas State Sales Tax Files), tests for significant mean differences on key characteristic variables between responding and nonresponding firms were conducted. The only significant differences found revealed that respondents from the *Dun & Bradstreet* sample had less employees and lower sales levels than nonrespondents from the same source and that respondents from the *Directory of Texas Manufacturing* sample had less employees than nonrespondents from the same source. The differences suggest that care should be taken when generalizing from the results of this study to firms in the *Dun & Bradstreet and Directory of Texas Manufacturers* directories in general.

The second test compared the responses provided on the survey to the same data published by the three sample sources. To do this, the difference between the value in the published source and the value in the survey was calculated for each observation in the sample. The only found significant difference was that the Sales Tax Files listed firms as being an average of 5.42 years younger than reported by the owners on the survey. Date of first sale was used to mark the age of the business in the survey while the Sales Tax Files provide data on the date of sales tax number issue. The difference in firm age may result from the fact that some firms are issued new sales tax numbers after experiencing an event such as a change in the name of the business or a change in ownership. Busenitz and Murphy (1996) found that the Sales Tax Files accurately reported the age of the business 71.7 percent of the time. It is possible, therefore, that the remaining 28.3 percent is capable of biasing the reported age of the business. Also, Busenitz and Murphy (1996) considered a recently purchased business as being new while this study considered the date of the original sale independent of changes in ownership. The result of this second test suggests that respondents have been consistent and accurate in reporting data about their firms.

Construct Exploration—Measures

Satisfaction with Performance. Data were gathered to measure respondent's stated satisfaction with growth and satisfaction with profitability. Respondents were asked to indicate on a five-point Likert scale their satisfaction with the growth of the business. A parallel question asked respondents to indicate their satisfaction with the profitability of the business. This approach parallels Cooper and Artz (1995) who asked respondents to assess their satisfaction with their venture's sales and profits.

Objective Performance. Four measures of firm growth were used: (1) absolute change in employees over the preceding two years, (2) percentage change in employees over the same time period, (3) absolute change in sales, and (4) percentage change in sales over the same time period were used. Respondents were asked in the survey to provide information on total full-time equivalent employees and revenues for the corresponding years.

Five measures of profitability were used in the study: (1) return on assets, (2) return on equity, (3) return on sales, (4) net income, and (5) owner's draw. The survey asked respondents to provide information on components required to calculate return on assets, equity, and sales. Net income was one of those components. Owner's draw was measured in categories. Respondents were asked to indicate their total compensation from the business in the previous year. Eight categories were provided ranging from less than $10,000 to more than $1 million. All of the growth and profitability measures used in this study have been used by prior researchers studying entrepreneurial performance (Murphy et al. 1996).

Environmental Hostility. Two variables were used to measure perceived environmental hostility: (1) perceived frequency of price wars and (2) perceived intensity of price wars. Survey respondents were asked to assess the level of competitiveness in their industry, using a five-point Likert scale, on the frequency of price wars and the intensity of price wars. Strong price competition is a classic measure of competitiveness in an industry (Porter 1980). The correlation between price war frequency and price war intensity was .91 (coefficient alpha was .97). Frequency of price wars and intensity of price wars were combined and averaged to form a composite measure of environmental hostility.

Vulnerability. Three measures of vulnerability were used in the study. Debt to assets and debt to equity were measured as the firm's total debt to total assets and total debt to total equity respectively. The third measure was firm liquidity. The current ratio (current assets divided by total current liabilities) was used to measure liquidity. Data for these measures were gained by asking respondents to provide basic balance sheet financial information. Firms high in debt to assets and equity and low in liquidity are more vulnerable to bankruptcy. The three measures were normalized, combined and averaged to form a single measure of vulnerability. The coefficient alpha for the three-item scale was .87.

Perceived Competitive Advantage. Resource advantage was operationalized as the extent that firms possess resources that are valuable, rare or unique, difficult or costly to imitate, and efficiently used (Barney 1991). Respondents were asked to identify from a list the two resources that are most important for their business. Two spaces were provided for respondents to identify resources not on the list. Four subsequent questions asked respondents to rate the previously identified resources as to their value, uniqueness, difficulty or ease to imitate, and efficiency of use, through the use of Likert-type scales. The ratings of the identified resources were then combined to form a single measure of resource advantage (coefficient alpha was .73).

Generic business level strategic advantage was measured using five items. Respondents were asked to assess, compared to their competitors, the extent that their business charges a low price, emphasizes product quality, offers a full range of products, emphasizes customer service, and has a lot of customer loyalty.

Perceived *competencies* of the entrepreneur were measured by using items from the scale developed by Chandler and Jansen (1992). In particular, items were taken to measure the entrepreneurial, political or resource acquisition, and managerial competencies of the respondents. The scales developed by Chandler and Jansen have been empirically shown to have adequate reliability (Chandler and Jansen 1992) as judged by the standards established by Nunnally (1978). For this study, the subscales were found to have coefficient alphas of between .75 and .76.

To make the study more parsimonious, an attempt was made to further reduce the perceived competitive advantage data. Specifically, factor analysis using varimax rotation found three strong factors. The first factor included customer service, product quality, and customer loyalty (loadings between .78 and .89) and was retained and labeled differentiation. The second strong factor included the three self-assessed competency variables (loadings between .67 and .80) and was retained and labeled competencies. Only the variable low price loaded strongly on the third factor (.97) and was retained and labeled the same (low price). Resource advantage was retained as a separate variable since it did not load well on any of the factors.

Commitment. Four measures of commitment were used in this study. Six items from Porter and Smith's (1970) Organizational Commitment Questionnaire were modified to reflect an entrepreneur's organizational commitment to a specific business as a measure of emotional commitment. The coefficient alpha for the scale was found to be .75. Education level was measured as the highest degree earned. Initial size of the firm and total investment in the firm were used as measures of total resources committed. Initial size was measured as the number of employees and sales level one year after the firm made its initial sale. Respondents were asked to provide this information on the questionnaire. Initial (or very early) employees and initial sales were standardized and then combined to form a measure of initial size (correlation was .57, coefficient alpha was .73). Total investment in the firm was measured by asking respondents to indicate how much money they and others had invested in the business, excluding reinvested profits. An attempt was made to further reduce the commitment variables, however, none of the variables loaded well together and the four commitment measures were unchanged as a result.

Methodology and Results

First, simple zero-order (Pearson's) correlations were calculated. The correlations between the objective measures of growth and profitability and the subjective measures of performance (satisfaction with growth and satisfaction with profits) are presented in Table 1. Overall, the positive correlations between the objective and subjective measures of performance show that H1 is largely supported. All of the objective measures except return on equity were found to be significantly positively related to satisfaction with profitability. Interestingly, all four of the objective growth measures were found to be significantly related to satisfaction with profits. The same four growth measures were found to be significantly positively related to satisfaction with growth. Net income and owner's draw were also found to be significantly positively related to satisfaction with growth. The three return measures of profitability return on sales, return on assets, and return on equity, however, were not significantly related to satisfaction with growth.

Next, these eleven variables were then factor analyzed to see how they loaded onto the constructs. This factor analysis is presented in Table 2. The results show that the variables loaded onto four constructs (growth, profit efficiency, raw profits, and satisfaction with performance), and that all the variables, except absolute growth in sales, loaded specifically onto one construct. Overall, the first three constructs related to objective performance while the fourth construct related to subjective performance.

Table 1. Correlations Between Measures of Growth, Measures of Profitability, Satisfaction with Growth, and Satisfaction with Profitability

	1	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*
1. Absolute Growth in Sales										
2. Percentage Growth in Sales	**.50									
3. Absolute Growth in Employees	**.38	**.41								
4. Percentage Growth in Employees	**.34	**.53	**.68							
5. Net Income	**.48	**.16	**.21	.09						
6. Return on Sales	-.10	.07	.01	.04	**.29					
7. Return on Assets	-.05	.02	-.09	-.01	**.31	**.72				
8. Return on Equity	-.04	-.05	-.06	-.09	.08	**.33	**.37			
9. Owner's Draw	**.38	.06	**.19	*.13	**.55	**-.16	-.09	-.08		
10. Satisfaction with Growth	**.29	**.24	**.28	**.32	**.15	.03	.05	-.04	**.24	
11. Satisfaction with Profitability	**.19	**.19	**.19	**.17	**.22	*.11	*.14	-.03	**.33	**.50

* p<.05 ** p<.01

As indicated, percentage and absolute growth in employees and percentage growth in sales loaded onto the growth construct, explaining 27 percent of the total variance. Return on sales, assets, and equity loaded onto a single construct that we term profit efficiency, explaining more than 19 percent of the variance. Net income and owner's draw loaded onto the construct raw profits, explaining greater than 13 percent of the variance, while absolute growth in sales loaded about equally onto growth and raw profits. Finally, satisfaction with profitability and growth loaded onto a separate construct, satisfaction with performance, explaining more than 10 percent of the variance. Clearly, H2 is supported, with all but one measure of performance loading onto separate factors and satisfaction with performance measures loading separately.

The growth, profit efficiency and raw profits factors were retained and used throughout the remainder of the study. Satisfaction with growth and satisfaction with profitability were combined and averaged to form the composite measure, satisfaction with performance. The correlation between the two measures was .50 and the coefficient alpha for the two-item scale was .67.

Table 2. Factor Analysis of Measures of Growth, Measures of Profitability, Satisfaction with Growth, and Satisfaction with Profitability

	Objective Performance			***Subjective Performance***
	Growth	Profit Efficiency	Raw Profits	Satisfaction with Performance
Percentage Growth in Employees	**.85**	-.02	-.03	.17
Absolute Growth in Employees	**.81**	-.06	.11	.04
Percentage Growth in Sales	**.76**	.05	.11	.11
Return on Assets	-.04	**.88**	.05	.11
Return on Sales	.05	**.88**	-.03	.08
Return on Equity	-.05	**.61**	.04	.11
Net Income	.10	.32	**.85**	.05
Owner's Draw	-.02	-.19	**.81**	.26
Absolute Growth in Sales	**.51**	-.08	**.59**	.02
Satisfaction with Profitability	.02	.06	.18	**.87**
Satisfaction with Growth	.27	-.02	.07	**.80**
Eigenvalue	2.97	2.12	1.45	1.15
Percentage of Variance Explained	27.02%	19.27%	13.35%	10.43%

Next, hierarchical linear regression was used to test hypotheses 3 through 6. Specifically, F tests for significant changes in R-squared were used to test the hypotheses. The results of the analysis are presented in Table 3.

Equation 1 assessed the extent that the objective measures of performance affected satisfaction with performance and established the baseline for testing the remaining hypotheses. Equation 1 was significant at the .01 level of statistical significance, providing further, partial support for hypothesis 1. Growth and raw profits were found to be significantly related to satisfaction with performance. Profit efficiency, however, was not significantly related to satisfaction with performance. Interestingly, the objective measures explained only 13 percent of the variance in satisfaction with performance.

Equation 2 then tested hypothesis 3, that perceived environmental hostility,

Table 3. Hypotheses Tests Using Two-Stage Hierarchical Regression Dependent Variable: Satisfaction with Performance

Variables	*Equation 1*	*Equation 2*	*Equation 3*	*Equation 4*	*Equation 5*
Stage 1					
Objective Performance					
Growth Factor	***.25	***.25	***.25	***.25	***.25
Profit Efficiency Factor	.05	.05	.05	.05	.05
Raw Profits Factor	***.27	***.27	***.27	***.27	***.27
Stage 2					
Environmental Hostility		*-.11			
Vulnerability			***-.16		
Perceived Competitive Advantage					
Differentiation				*.12	
Low Price				*.10	
Competencies				***.25	
Resources				*.11	
Commitment					
Education					*-.12
Emotional Commitment					***.32
Initial Size of the Firm					*-.10
Total Investment in Firm					*-.12
F	***19.30				
Adjusted R2	.13	.14	.15	.24	.27
Significant Change in R-Square (F)		*5.37	***11.03	***17.78	***20.52

* $p<.05$ ** $p<.01$ *** $p<.001$

Equation 1 (H1): $SP = ß_0 + ß_1$(Objective Performance) + error
Equation 2 (H3): $SP = ß_0 + ß_1$(Objective Performance) + $ß_2$(Environmental Hostility) + error
Equation 3 (H4): $SP = ß_0 + ß_1$(Objective Performance) + $ß_3$(Vulnerability) + error
Equation 4 (H5): $SP = ß_0 + ß_1$(Objective Performance) + $ß_4$(Perceived Competitive Advantage) + error
Equation 5 (H6): $SP = ß_0 + ß_1$(Objective Performance) + $ß_5$(Commitment) + error

SP = Satisfaction with Performance

controlling for objective performance, would predict additional variance in satisfaction with performance. The adjusted R-square was .14 and the change in R-square was statistically significant at .05, providing support for hypothesis 3. The results of this study indicate that environmental hostility is negatively related to satisfaction with performance, when controlling for objective performance.

Next, equation 3 tested whether, controlling for objective performance, vulnerability would explain additional variance in satisfaction with performance. Vulnerability was found to be strongly negatively related to satisfaction with performance. The change in R-square was significant at .001 and the adjusted R-square was found to be .15. Therefore, hypothesis 4 receives strong support.

Equation 4 tested whether perceived competitive advantage would explain additional variance in satisfaction with performance, controlling for objective performance. Table 3 shows that the change in R-square was significant at .001, providing support for hypothesis 5. Combined, these variables nearly doubled the percentage of variance explained in satisfaction with performance (adjusted R-square of .24). Competencies, resources, differentiation, and low price were all found to be significantly positively related to satisfaction with performance.

Equation 5 tested whether controlling for growth, if commitment (measured by commitment, education, initial size of the firm, and total investment in firm) would explain additional variance in satisfaction with performance. Table 3 shows that the change in R-square was very significant (F=20.52), offering strong support for hypothesis 6. For this equation, the adjusted R-square was more than double that of the model considering only objective measures of performance. Emotional commitment, education level, initial size of the firm, and total investment were all found to explain additional variance in satisfaction with performance. Of the four significant relationships, only emotional commitment was positively related to satisfaction with performance.

Although not a hypothesis test, it is interesting to note that when the objective performance, environmental hostility, vulnerability, perceived competitive advantage, and commitment variables are entered into an equation together, they explain more than 34 percent (adjusted R-square) of the variance in satisfaction with performance. This stands in contrast to the 13 percent of variance in satisfaction explained by objective measures of growth and profitability. Clearly, satisfaction with performance is affected by much more than objective performance measures.

Discussion

Ultimately, the results of this study reaffirm the conclusions of Bommer et al. (1995) and Dawes (1999) that objective and subjective performance measures are positively correlated, yet should still be considered separate constructs. The correlation analysis shows many significant positive correlations between the subjective measures satisfaction with growth and profitability with the objective measures of performance. The factor analysis, though, shows that these eleven variables loaded separately onto our constructs: growth, profit efficiency, raw profits, and satisfaction with performance. As such, it is important to note that the various objective and subjective measures of performance should not be considered interchangeably.

Next, this study proposed and tested a model of factors predicted to affect satisfaction with performance. Variables pertaining to environmental hostility, vulnerability, perceived competitive advantage, and commitment were shown to explain additional variance in satisfaction with performance, after controlling for actual performance (growth and profitability). Therefore, consistent with Cooper and Artz (1995), this study confirms the notion that satisfaction with performance seems to be an important variable of interest in its own right. Satisfaction with performance derives from more than actual profitability and growth.

Clearly, the satisfaction of entrepreneurial owners is a much more complicated process than simply being the result of actual profitability and growth. Given the importance of owners as key stakeholders, and the resulting impact on commitment that is so important for future growth and profitability (Cooper and Artz 1995), satisfaction is clearly of critical importance for the study of entrepreneurship and performance. As such, this study has established the importance of satisfaction, as well as its being a deep and subjective concept. For these reasons, studies such as this about entrepreneurs' satisfaction provide a worthy research topic.

However, care must be taken in drawing conclusions or generalizing from the results of this study. First, the study applies to manufacturing industries and to small and young firms. As such, the results may not be generalizable to other industries or more established firms.

Second, while this study addresses variables explaining additional variance in satisfaction, it is quite likely that satisfaction with performance, will in turn, affect other variables, particularly commitment. The organizational behavior literature includes numerous studies that consider both organizational commitment and job satisfaction (DeConinck and Bachmann 1994; Parnell and Crandall 2003), with each variable repeatedly used as a predictor of the other. Nevertheless, substantial literature has focused on job satisfaction because it is considered such a critical outcome variable in organizations (Griffin and Bateman 1986; Parnell and Crandall 2003), with organizational commitment predicting job satisfaction. Similarly, this study considers satisfaction as an outcome of entrepreneurial commitment. Our approach is also consistent with Cooper et al. (1994), who viewed educational and capital commitment as predictor variables.

However, Cooper and Artz (1995) did argue that satisfaction may impact investment and continuance decisions. Therefore, future studies may need to consider the corresponding effect of satisfaction on commitment, as well as other variables. Perhaps future research should take a longitudinal approach to measuring the mutually reinforcing effect of satisfaction and objective measures of performance. For example, an increase in satisfaction in the short term, resulting from perhaps perceptions of competitive advantage or risk, may then lead to increased commitment over the long term, also resulting in increased satisfaction, and so on. The current study and the model proposed here is just the beginning. Much more research on entrepreneur's satisfaction and performance needs to be done.

Acknowledgments
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Endnote
[1]Cooper and Artz (1995) measured entrepreneurial satisfaction with four items: satisfaction with venture sales, satisfaction with venture profits, overall satisfaction with the business, and willingness to start the same business again.

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About the Authors

GREGORY B. MURPHY (gbmurphy@usi.edu) is an assistant professor of management at the University of Southern Indiana. He received his Ph.D. in business administration from the University of Houston. His research interests are in the areas of entrepreneurship and electronic commerce. He has previously published in the *Journal of Business Venturing, Journal of Business Research, Journal of High Technology Management Research, Journal of Business Economics Research,* and *New England Journal of Entrepreneurship.*

STEPHEN K. CALLAWAY (scallaway@usi.edu) is an assistant professor at the University of Southern Indiana in Evansville, Indiana. He received his Ph.D. in business administration from Temple University in May 2003. He teaches courses in strategic management and international business. His research interests include international entrepreneurship and management of technology. He has published in the *New England Journal of Entrepreneurship,* and has presented papers at various conferences, including winning the Best Graduate Student Paper award at the Midwest Academy of Management meeting in Toledo, Ohio, in 2001.

Omitted Variable Bias in the Link Between Planning and Performance

Kirk C. Heriot
Noel D. Campbell
R. Zachary Finney

This article argues that existing research poorly specifies the link between planning and performance because of omitted variable bias. Researchers agree planning is a critical part of creating any new venture. Many researchers assess planning by whether a small firm has a written business plan. Unfortunately, efforts empirically to validate this relationship have been inconclusive. This article proposes that researchers should assess business plans both on the quality of the plan (and the planning process that produced it), and on the quality of the underlying business opportunity. Failure to account for both aspects of a business plan amounts to omitted variable bias, frustrating attempts to accurately estimate the true relationship.

The business plan is commonly used as a factor for evaluating the relationship between firm planning and firm performance in small firms. Among the current models of entrepreneurship, many researchers have asserted a positive relationship between the use of formal planning and firm performance (see, e.g., Rue and Ibrahim 1998; Perry 2001; Fletcher and Harris 2002). Typically these models emphasize the use of written business plans (Rue and Ibrahim 1998; Sahlman 1997). However, the literature has not empirically demonstrated the expected relationship between formal planning (resulting in a written business plan) and firm performance in a consistent manner. In this article, we demonstrate the theoretical limitations of using business plans as a means of operationalizing formal planning in empirical research. Scholars frequently fail to properly account for multiple outcomes of the firm planning process, introducing omitted variable bias into their research.

We concur that a link probably exists between the use of written business plans by entrepreneurial firms and their subsequent performance (See e.g., Perry 2001; Fletcher and Harris 2002; Singhvi 2000; and Rue and Ibrahim 1998). We believe the tenuous nature of the empirical relationship may be explained from the perspective of both the content and the composition of the business plan (Trailer and Wolford 2001). The shortcoming from an empirical research perspective is the assumption that a written business plan represents good planning. That is, that the existence of a written business plan means that the principals in the entrepreneurial firm actually have engaged in planning, have produced a well-written and convincing business plan, have actually executed the plan, and that the perceived business opportunity was a tenable one.

In the next section, we review the literature. In the following section, we propose a model showing the situations that may be encountered when scholars operationalize planning through the use of business plans. We conclude by discussing the significance of this study for future empirical research.

Literature Review

Considerable research has evaluated the relationship between planning and firm performance, albeit usually in large organizations. However, more recent research has extended to small, entrepreneurial firms. Unfortunately, the small business findings are mixed. No clear picture of the relationship between formal planning and firm performance has emerged as various authors present conflicting findings. Some studies found a positive relationship (Perry 2001), while other studies have found a negative relationship (Hand, Sineath, and Howle 1987). Therefore, the impact of formal planning on performance is unclear.

Olson and Gough (2001) remark that problems begin with the different ways in which "formal planning" is defined. Further problems arise in the methods by which researchers operationalize formal planning. The most common method is to assess whether planning leads to a written document. Yet a written business plan may not be all that it appears to be. Sahlman argues that "the more elaborately crafted the document, the more likely the venture is to, well, flop, for lack of a more euphemistic word" (Sahlman 1997, p. 98).

The literature offers several explanations for the mixed results: differing definitions (Perry 2001), different means of operationalizing the construct (Olson and Gough 2001), and even questions over the extent to which business plans are actually produced by small businesses have been discussed (Parks, Olson, and Bokor, 1991). Sahlman (1997) suggests that entrepreneurs may be guilty of losing a theoretical perspective because their written plans reveal they do not have a business model that shows genuine insight into their perceived business opportunity. Hence, it is suspect whether many business plans have the proper perspective on what drives a particular venture. Thus, we would *not* expect the written plan to be a good predictor of firm performance if it does not reveal insight into the business concept. The issue is further complicated because, as Pearce, Freeman, and Robinson (1987) remark, past studies do not appropriately control for other relevant variables such as leadership or competition.

Another common theme in the literature is the distinction between the business plan document created to direct an entrepreneurial/small business versus the process of planning. Many researchers are alarmed that too much emphasis is being placed on the business plan rather than the process that creates the plan (see, e.g., Robinson 1982; Hills 1985; Parks, Olson, and Bokor 1991; Trailer and Wolford 2001). Hills (1985) was among the first to question the significance of a written document. He asked venture capitalists to provide their expert assessment of the extent to which the business plans involved in-depth market information. Venture capitalists in his study believed that entrepreneurs ignore negative information. Thus, serious questions are raised about whether a business plan is truly representative of an adequate planning process. Other researchers concur, questioning whether written business plans actually represent good planning because of a variety of potential problems associated with either the opportunity expressed in the plan (Sahlman 1997) or the composition of the arguments (Trailer and Wolford 2001). Hall and Mestler point out, "If your business concept is untenable, no amount of assistance from business plan software will make it fly" (Hall and Mestler 1997, p.45). The implication is that knowing the elements of a business plan and producing a document are not enough.

Trailer and Wolford (2001) note that the literature has not emphasized actually writing a business plan despite the research identifying the steps, the elements, and factors critical to the written document. They argue that "[m]erely listing the important topics in a business plan creates only generalities. Details must support the arguments made about and for the topics… That is, effective business plans are the outcome not only of covering all the bases, but also of covering them well" (Trailer and Wolford 2001, p. 41). They go on to argue that entrepreneurs may have great difficulty composing meaningful business plans because of the intricacies of writing sound, complex arguments.

Ironically, despite these concerns, much of the empirical literature continues to emphasize a counting procedure whereby firms are categorized by whether they have a written plan (Olson and Gough 2001). Very little of the research makes an effort to evaluate the effectiveness of the written document in a substantive way, assuming that the presence of a business plans indicates the firm has actually engaged in planning.[1]

An "Omitted Variable Bias" Schematic

We have developed a schematic model expressing firms' potential outcomes expected upon analysis of the *concept* and *composition* of business plans. Although our model will be of limited use to practitioners, we hope the model proves useful to researchers in understanding the empirical difficulties linking business plans and firm performance. We suggest that business plans may be evaluated on at least two dimensions. Empirical failure to account for *both* dimensions amounts to *omitted variable bias* in one's estimates of the relationship between business plans and business performance. In the first of the two dimensions, the business concept may either be tenable or not tenable (i.e., the idea may have genuine commercial potential or it may not have commercial potential). Second, the plan may be either well written or poorly written. A well-written plan will be persuasive, consisting of a number of complex arguments that "produce strong conclusions regarding the feasibility of starting a business" (Trailer and Wolford 2001, p. 41). Our two dimensions led to a 2x2 model depicting four outcomes. Each cell in the model is associated with a different outcome (see Figure 1).

In the lower left-hand quadrant is a company with a written business plan in which the concept is untenable and the document has poor composition. This situation is clearly associated with negative firm performance. Yet, if researchers use written business plans as a measure of formal planning, this firm would be categorized with firms possessing well-written business plans supporting tenable (or even untenable) business concepts. Such data confusion is an example of omitted variable bias and will lead to inefficient empirical estimates.

The upper left-hand quadrant represents a poorly written business plan based on a tenable concept. The problem with this type of document is that it may not be able to engage the people in the firm (Carland and Carland 2003). As such, the document is not persuasive and does not capture the support of the firm's employees. Because the underlying business concept is good, the firm *may* succeed, but it will do so *despite* its business plan, rather than because of its business plan.

The lower right-hand quadrant is a firm that has written a convincing business plan for a concept that is simply untenable, a frequent occurrence according to Sahlman (1997). The entrepreneurs convince themselves that their idea will work and may even be able to put together a flashy document to support their concept. However, a persuasive document is no substitute for a plan to economically produce a good or service a customer base actually wants. Empirically, firms in this cell would produce a negative relationship between planning and performance.

Business Plan Is/Details:	*Poorly Composed*	*Well Composed*
A Tenable Concept	This type of business plan may lead to positive firm performance, but it may overlook critical details due to poor execution, leading to implementation problems. The firm may be successful despite its business plan rather than because of it. *"planning" → poor performance*	A good concept that is well written is the most likely situation whereby a written business plan will be positively related to firm success. This is what researchers implicitly assume. However, it is also only one of four outcomes that may exist. *"planning" → good performance*
An Untenable Concept	Despite the presence of a written business plan, this situation will be correlated with poor firm performance. *"planning" → poor performance*	This type of business plan looks good, but resembles "lipstick on a pig." A well-written plan is not a substitute for a sound concept. This situation correlates with poor firm performance. *"planning" → poor performance*

Figure 1. Omitted Variable Bias: The Empirical Relationship between Written Business Plans and Firm Performance

In the upper right-hand quadrant of the model is a firm possessing a tenable business concept as documented in a well-composed business plan. This situation is what most researchers implicitly envision when they analyze the relationship between formal planning and firm performance. Such firms would produce an empirically significant, positive relationship between planning and performance. Unfortunately, this is an ideal situation for which there may not be many real-world examples.

Business plans are regularly evolving documents, so there can be some confusion as to what it means to "evaluate a business plan." However, for a plan to be effective it cannot change too rapidly or radically, or it loses its impact as a strategic document. Certainly, though, the literature evaluates plans and planning despite recognizing the ongoing process nature of both. Metaphorically, we can view evaluating a business plan as analyzing the occasional frame in a motion picture. Our schematic model is designed to demonstrate to scholars the potential source of omitted variable bias which has frustrated their empirical research. It will be of limited use, at best, for practitioners or consultants seeking to apply ex ante process control or ex post process analysis to a firm's planning.

This study has an important implication for future empirical research. The existing literature cannot seem to conclusively agree on the relationship between formal planning and firm performance. Our research suggests that we are placing far too much emphasis on the existence of a written plan, rather than on the content of the plan, whether planning was accomplished to write the plan, or the viability of the perceived business opportunity. The presumption that the mere presence of a business plan will lead to positive firm performance assumes that the business plan represents a good idea and that the plan has been well written. Our model suggests that at least three other outcomes are possible; it is these other outcomes that provide an explanation for the mixed results of empirical research. Firms with poorly written business plans and business plans based on untenable concepts—conditions expected to lead to poor firm outcomes—are empirically classified as having engaged in effective planning. Scholars should recognize that a richer means of assessing the relationship between planning and performance is needed, given the problems with traditional planning-performance research.

Unfortunately, discovering the existence of omitted variable bias is far easier than rectifying the problem. We believe we have *identified* the root problem that frustrates empirical researchers, but we have *not solved* it. Neither can a practitioner take our 2x2 schematic and produce a "can't fail" business plan nor assess the quality of her planning process. Our schematic indicates the need for empirical methods able to separate the quality of a business plan's arguments from the quality of the underlying business opportunity, ex ante. Therein lies the principal difficulty, as the most effective way of testing the quality of a perceived business opportunity is to observe the profitability of a firm organized to meet that perceived opportunity. Clearly, many market opportunities envisioned by entrepreneurs are, in reality, little more than wishful thinking. Yet the market is rife with examples of "bad ideas" that have become extraordinarily successful, such as Famous Amos and FedEx. This may be the true "omitted," unobservable, variable that has complicated researchers' estimations.

The presumption that the mere presence of a business plan will lead to positive firm performance assumes that the business plan represents a good idea which has been well written. Such a simplistic approach ignores the actual complexities: to be beneficial to a firm, its business plan must embody a sound business concept, and must be well written. These, along with a large portion of sheer luck and pockets full of capital, may be the bare essentials of a successful firm. Attempts at humor aside, there is no a priori reason to assume the mere existence of a business plan should be correlated with firm success. Failure to properly account for this complexity is one reason for the empirical difficulty linking business plans with firm success.

Endnote

[1] However, Perry (2001) and Parks, Olson, and Bokor (1991) found that very few small firms actually create business plans. Carland and Carland (2003) suggest that evaluating entrepreneurs' use of business plans may be the wrong direction to go, as they question the extent to which entrepreneurs actually engage in this traditional form of planning.

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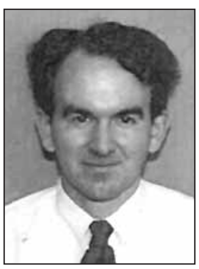
About the Authors

KIRK C. HERIOT (kirk.heriot@wku.edu) is an associate professor of management and entrepreneurship at Western Kentucky University. He earned his Ph.D. in industrial management with a concentration in Strategic Management at Clemson University in 1996. Dr. Heriot's research has been accepted for publication in numerous journals including the American Business Review, Journal of Supply Chain Management, Journal of Small Business Strategy, and Journal of Management Education. In 2004, Dr. Heriot and a colleague won the Distinguished Research Award at the Allied Academies Annual Conference. Dr. Heriot's primary area of scholarly research is entrepreneurship in challenging environments.

NOEL D. CAMPBELL (ndcampbell@ngcsu.edu) is an associate professor of business administration at North Georgia College & State University. He earned his Ph.D. in economics at George Mason University in 1997. Dr. Campbell's research in economics has been accepted for publication in numerous journals including in the Eastern Economic Journal, Journal of Education Finance, and Public Finance Review. He has also collaborated on cross-disciplinary research that has been published in the Journal of Management Education and the Journal of Small Business Strategy. Dr. Campbell's primary area of scholarly research is public choice.



R. ZACHARY FINNEY (rzfinney@ngcsu.edu) is assistant professor of marketing at North Georgia College & State University. He earned his Ph.D. in marketing from the University of Alabama in 2001. Dr. Finney's research has been accepted for publication in numerous journals including the Journal of Business Research, Journal of Management Education, and Marketing Management Journal. In 2003, Dr. Finney and two colleagues won the Steven J. Shaw Award for the Outstanding Conference Paper at the Society for Marketing Advances Annual Conference in New Orleans. Dr. Finney's primary area of scholarly research is marketing strategy.

Case Study
DHR Construction, LLC[1]: Parts A and B

Herbert Sherman
Daniel J. Rowley

Stephen Hodgetts read the e-mail over and over again and still could hardly believe what he had read. He had just come back from his vacation, well rested and refreshed, and this e-mail had dampened his high enthusiasm. It took time to absorb such bad news and for Hodgetts to get over his incredulity. Yet in the end Hodgetts accepted the truth—a deep, dark terrible truth that would not go away. Robert Davis, his business partner's son, had confirmed in an e-mail his worst fears about their newest business partner, David Russ. Many thoughts were running through his mind simultaneously yet each screamed to be heard. "How could he and his partner Richard Davis have been so blind, so trusting?" "How could Russ not have heeded the advice of his business partner, Richard Davis, Russ's former English professor?" And most important, "What was now going to happen to their new business?" Yet the one thought that continued to echo among them all was surprisingly a quote from Sir Arthur Conan Doyle's beloved character, Sherlock Holmes: "But there are always some lunatics about. It would be a dull world without them."

In the Beginning…(Part A)

In August 2002, when the Dow Jones Industrial Average dipped under 8000, Davis and Hodgetts, friends, coauthors, and fellow English professors, lamented their desiccated retirement funds. Neither was getting any richer on a faculty member's salary nor expected any windfalls from relatives, their book sales, or lottery tickets. After a long discussion, they decided that they needed to become masters of their own economic fate. Richard Davis had done enough preliminary research on the real estate market in their area to convince Hodgetts (who had a bad experience renting his house several summers ago) that there was money to be made becoming what Hodgetts half jokingly called "slum lords." In September 2002, they formed D&H LLC, each investing $50,000, with the idea of buying a total of 10 homes by the following year.

Davis and Hodgetts, with the assistance of Davis's real estate agent, found renters in three months and worked with these families to find them homes in the $175,000 price range that the families would be happy to lease with the option to buy. The rentals were so attractive that Davis and Hodgetts even had a waiting list for new tenants. Davis and Hodgetts easily qualified for mortgages but found that the interest rates were higher than they expected as the homes were purchased as rental properties and not primary residences. They decided to put 10 percent down on each property and to use a three-year adjustable rate mortgage to drop the interest rate and their monthly expenses to about $900 a month. They also found that they needed to invest another $10,000 into each home for real estate brokerage fees, appliances, interior design, and landscaping. The six homes they had purchased gobbled up their initial investment of $100,000 and required an additional $80,000 (which Hodgetts loaned the company). Their net profit was $1,500 a month, certainly not enough funds to purchase the planned additional four homes, but enough funds in their minds to merit continuation of the business. Property values of these homes were rising at about 10 per year. Hence, the real economic benefit derived from the business would be realized at the end of the three-year lease, when the renters either bought their homes or when the homes would be resold.

Davis and Hodgetts purchased only newly constructed homes for their rental business. This reduced their time spent managing the properties and attracted the interested renters who would be willing to purchase their house at the end of the three-year lease. Davis and Hodgetts believed that these new homes would have minimal repair problems over the three-year time span of the lease and that they would therefore have little, if any, interface with any subcontractors (i.e., carpenters, plumbers, electricians, gardeners) in the future.[3] For Davis and Hodgetts the rental business was supposed to be a sideline to their academic careers and certainly was not going to cut into their quality time as academics.

Any problems with the six properties (and there were very few) when Richard Davis was not at home to answer renters' calls, Adrienne Davis, Richard's wife, resolved. She would contact the home's building contractor. Work that was performed on the newly purchased homes (one home had a flooding problem) was covered by the builder's warranty, therefore, there were no out-of-pocket expenses. Any phone traffic or other day-to-day activities related to the business, what little there was, was usually handled by Mrs. Davis since Drs. Davis and Hodgetts spent much of their time at the university. This included collecting rent checks, paying the properties' mortgages, and making bank deposits.

A Short-Term Solution and a New Game Plan

Their solution to raising cash for down payments on new rental properties was to finish off the basements of their renters' apartments, and then remortgage their properties. They could finish the basements off for approximately $20,000 per home and increase the appraised value of the property by nearly $30,000. If they did this for all six homes, they could raise $60,000. While talking with their renters about the possibility of finishing off their basements, they discovered that one couple, Alan and Wilma, were not only willing to finish off their own basement but would be willing to finish the basements of the other houses for $5,000 less per home.

The work was well underway to finishing off the basements of their six rental units in April 2003. Alan and Wilma formed their own LLC and completed three basements (including their own) while Davis and Hodgetts refinanced those three homes and were able to clear about $45,000. With these funds, they purchased an additional two homes bringing their total number of rental units to eight.

It was late April when Davis was approached by one of his most recent graduates, Russ, who was designing their basements including drawing the blueprints, about cutting out the middleperson in terms of the rental business by building their own homes. Russ, a young man who had just recently graduated from Davis and Hodgetts' university with a degree in business administration (specialization in management), worked in the home construction industry for several years part-time as both a general construction worker, and then as an assistant designer. During the past year Russ had formed his own LLC (DR Architectural Designs), with the intention of going into the business full-time once he graduated from college. Working for Davis and Hodgetts designing basements was quite fortuitous for Russ who saw real opportunity in this new venture of home construction.

Russ acted as the contractor. Although he never served as a contractor before, he felt quite confident that his industry experience and his educational background in business provided him with the skills necessary for managing a home construction project. More importantly, given his prior work experience, he knew all of the subcontractors in the area who were needed to construct new homes. He felt confident in his ability to work well with people whom he considered his friends and to manage the process. Russ had taken numerous courses on motivation, leadership, and business operations and knew that his college education would serve him well on his first major managerial position.

Davis was highly impressed with Russ's hard work and dedication as a student in his class and felt that these traits would carry over well to the work environment. Davis had known Russ to be an affable and capable student and vouched for his character to Hodgetts. Alan and Wilma would do the interior work, and/or Alan could hire some part-time workers to help him. In any event, Davis and Hodgetts would build the rest of their homes under a different company name, sell it to themselves for a profit, and then make a profit renting the homes. Davis estimated that on a $150,000 home they could net a 20 percent profit; $30,000 over the two- to three-month time period it would take to build one home.

A New Entrepreneurial Venture—The Birth of DHR Construction, LLC

In talking with Davis about this project, Russ noticed that the team of Davis and Hodgetts, academics by training, had many of the same characteristics that his course on entrepreneurship taught him were critical in becoming successful start-up business owners. These traits included: high drive and energy level, self-confidence, setting challenging but realistic goals, using money as a measure of performance, persistent problem-solvers, moderate risk takers, taking initiative and taking personal responsibility, and making good use of resources.[4] Russ was further impressed with the operation of Davis and Hodgetts' current enterprise since it was clear to him that this was more than just a hobby business—Davis and Hodgetts were depending on the rental business for their future retirement income.

Hodgetts met Russ for the first time at the signing of the LLC agreement and they seemed to hit it off quite well. Their lengthy discussions about the business confirmed Russ's observation about Davis and Hodgetts' entrepreneurial bent. Yet looking back upon this conversation an objective observer might note that certain issues were surprisingly absent from this discussion as well as any previous discussions about the new venture; specifically the marketing and promoting of the business, networking techniques, and initial preparation for the new venture.[5]

According to the agreement, Davis and Hodgetts would have controlling interest in the firm (37.5% each) while Russ would be a minority shareholder at 25 percent. No one consulted a lawyer about the contract, which they all had been given a copy of ahead time. Davis assured both Hodgetts and Russ that this was a standard LLC agreement—one in fact he took off of the Internet and was written given their particular state's LLC's requirements. After much hemming and hawing by Hodgetts, who tended to object to any new venture proposed by Davis, Hodgetts and Davis formed a construction company with Russ, DHR Construction, LLC.

DHR developed a simple business model. Homes would be priced at 20 percent above cost. Russ would act as the architectural designer and contractor. His job was to work with the subcontractors to ensure that their work met schedule and building code requirements, and to make sure that subcontractors' bills coincided with the work provided. Russ was to bill DHR Construction, LLC for his services under his own LLC, leaving DHR with no salaried employees. Davis handled the back office functions of the business (hiring an accountant, pricing out homes, bidding out work to subcontractors, working with real estate agents, and mortgage companies) while Hodgetts played creditor and bankrolled the company's upfront expenses. Hodgetts also took a more active role in Davis's and Hodgetts' academic career by becoming first author on several books and journal articles that he and Davis were jointly working on.

The business was progressing quite nicely—in the opinion of Hodgetts, Davis, and Russ. Davis had located a bank that offered them construction loans at 75 percent of the estimated retail value of the homes to be built for a competitive lending rate,[6] thus requiring at most a 5 percent loan from Hodgetts to cover minor expenses (assuming a 20% profit margin per home). Norma, their home rental agent, had found them vacant property in the same general vicinity of their rental properties, with each parcel running between $40,000 to $45,000. Their mortgage company for their rental units offered them extremely favorable mortgage rates if Hodgetts and Davis decided to buy their own homes for rental purposes. In the interim, Hodgetts lined up a publisher for a fictional piece of work that he and Davis had always wanted to write—*The Bard Meets Sherlock Holmes*. Hodgetts drafted an outline of the text which received very favorable reviews from the publisher.

Russ, their new business partner, was also quite busy. He lined up all of the subcontractors needed to build their homes (including Alan and Wilma who would handle framing and walling) and developed several designs for homes in the 1250 to 1400 square foot range that would sell for $165,000 to $185,000. Russ's homes included some added features that differentiated them from other houses in a similar price range, (i.e., more windows, including a garage window, nicer lighting fixtures, upgraded appliances, nicer counters, cabinets, and flooring) including a distinctive California design, featuring an oversized master bathroom, archways, high ceilings, and unique fireplaces. The three partners agreed with their real estate agent that many of these upgrades added minimal cost to the overall price of the home and accentuated customer value.

Of Mice and Men

The strategy was to immediately construct two homes based on the plans developed by Russ. Each property was to be purchased by each of the majority shareholders (Hodgetts and Davis) who would then quick title the land to their property management company, D&H Management. These contributions represented each owner's equity investment in DHR Construction. Russ's contribution came in the form of sweat equity—much of the startup work on these homes was performed for free although his firm was paid for the architectural drawings.

Construction loans were then obtained based on Russ's architectural drawings, Davis's cost analyses, and the real estate agent's assessment of a competitive selling price for the property. Hodgetts was on a sabbatical feverishly working on *The Bard Meets Sherlock Holmes* and contributed the least to the day-to-day operations, although, he attended all of the company's meetings. The ground was broken quickly, pictures were snapped of the event, company t-shirts and hats were distributed to owners and subcontractors alike, and construction was well underway. Adrienne Davis, who had recently received her MBA, even got into the DHR operation (for no compensation) by organizing meetings and coordinating communications between the office (Davis's home) and the construction site.

While on the surface everything seemed to be going fine, an undercurrent of discontent was running through the ranks of DHR's subcontractors, especially Alan and Wilma. They complained bitterly to Adrienne that Russ was both crude and rude in his dealings with them, and the other subcontractors, and that Russ had threatened to fire them if they protested his actions to Davis and Hodgetts. Other subcontractors were complaining to both Davis and Adrienne that they had be called into a project by Russ either too early, when the work was incomplete (and therefore they could not do their own work), or too late (they'd have to work around someone else's work). Property was also disappearing from the work sites, especially with wrong orders where goods would have to be picked up for return by the deliverer. Both homes were running over budget and the quality of the work being performed was inconsistent and not always up to building codes.

In May 2003, less than two weeks into construction, Adrienne decided to intervene and have a chat with Russ. She gave him a chance to reflect on the feedback that she was getting. She told Hodgetts in an e-mail that "my lunch with Russ went well. We brainstormed bringing his wife into the business as a PR representative. Meaning, she would schedule the subs, bake cookies for them, and visit the job site to listen to concerns. That would take pressure off Russ and make him a better manager. There are still rough edges on him, but he enjoyed our time together. I'll do it again." Hodgetts replied, "Russ is young, inexperienced, and probably a bit over his head—a normal reaction would be to give orders and criticize others but I'm sure that you can break him of this habit!" Davis seemed less concerned than his wife about Russ's behavior—no one had complained to Davis about Russ and when Russ and Richard (Davis) were together on the site, everything seemed fine and everyone seemed happy.

The Plot Thickens

According to Adrienne, however the situation was getting worse. "My anger toward David Russ continues to grow," she confided in Hodgetts a week after the meeting. "Now I have learned that he may be undermining our relationship with various subs. He rushed the roofers to finish. Now the heating people have to drill holes and repair them to finish their part. He is unrealistic about deadlines. We may lose business over his behavior. That is unacceptable to me."

"Alan is the one who smoothes things over for us once Russ has left the job site. Thank God for Alan! Russ needs to know it's not just me, Adrienne, who is upset about his behavior. He writes me off because I'm a woman, and he believes that I don't understand the nature of the construction business. I don't buy that one! These are people issues that pertain to any business." Adrienne then took a long pause in which to catch her breath.

"I have counseled Russ to speak more softly and to give Alan permission to question him and ask for clarifications. I have also counseled Alan to speak up and not take Russ's behaviors to heart. Alan is such a gentle spirit. Russ is such a bull. We'll see how time plays out with these discussions. Russ wonders why he doesn't get more respect. There's a topic to explore with him. Respect doesn't come from yelling orders at people. He has no sense of how to express gratitude to our subcontractors. It's all about him.

Richard is tired of talking about it. He just wants things to go away. I know they won't without some action. I asked Richard to consider using Russ in another role, or dissolving the corporation. This is a small college town and word gets around. I don't want his attitude to bring us down. We have such a wonderful team otherwise." She took another long breath before she continued.

"Stephen, would you be willing to address this issue with Russ? I think he is in over his head and doesn't really know how to function with people on the job site. His ego is huge. If he brings relatives around to show off the place, he is worse, giving everyone orders as if he runs the place. He creates an unhealthy workplace environment. Perhaps some words from you about being humble and caring would have an impact. Hearing the message from several places might help it sink in. Thanks for listening."

Hodgetts was placed in a real bind. He respected Adrienne's opinions and thought very highly of her ability to read people. He also valued his long-time writing partner and could not believe that Richard would overlook such a glaring problem. Russ might be Davis's former student but Hodgetts could not imagine Davis coddling Russ. He hoped that his reply to Adrienne would be both thoughtful and diplomatic. "You have posed a real conundrum for me since I am not involved with the day-to-day operations and I have no real contact with the subcontractors. I am therefore even more removed, at least in Russ's eyes, than you are from the business. Advice from me at this point, if you pardon the expression, would be like pissing into the wind."

Adrienne looked a bit perturbed but seemed to accept Hodgetts' comments with grace. Hodgetts continued, "I think that you and Richard need to sit down with Russ and his wife and have a good clearing of the air. Richard needs to set the ground rules, explain that he is the principal owner and therefore the boss, and discuss with Russ our way of working with people. I'm sure that Richard and Russ can work these things out once everyone puts their cards on the table."

The Meeting

Hodgetts had a nice chat with Davis who concurred that a meeting would put this issue to bed once and for all. The meeting went well according to Davis. "I had a very good chat with Russ, who brought his wife, yesterday afternoon. His wife was far more upset and angry than Russ, well at least that's the way it appeared, but we talked through all of the issues. Adrienne is not convinced that Russ is changing that much, but I don't particularly agree. Alan and Wilma have to be more assertive and speak up for themselves rather than tell Adrienne about their problems. This will keep Adrienne from then getting angry on their behalf. Anyway, at the moment, I think things will settle down."

Adrienne had a slightly different perspective but agreed with the outcome. "Richard asked me to stay for the meeting with Russ. Russ brought his wife, as she was upset as well. It was good. They needed to be angry and express their frustrations. Amazingly, none of this upsets me. I embrace the challenge of understanding. No tears! We left with everyone feeling better. I can't say the discussion is over, as Russ doesn't express any ownership of the problems." In a mocking, sarcastic tone she continued, "There needs to be bosses. He is doing alright. He's done it all. He has lots of expertise. On and on. He talks fast and loud. I just listened. Richard spoke out of his frustrations with the issues. Mostly to have this resolved, as he is tired of this nonsense! Russ's wife does hear and hopefully will help Russ to see what needs to happen."

From Hodgetts' standpoint the meeting actually turned out better than expected. He was sure that Richard would put in his two cents in terms of who calls the shots and that Richard would reiterate the need for Russ to be a team player. He was also certain that Russ would see this problem as an issue of competence (not compassion) and that Russ unfortunately would not understand that it isn't always the smartest person who makes a good manager, it is the one who possesses excellent interpersonal skills.

When the Mice Are Away

It was only a few weeks later, in early July, that Richard Davis and his wife planned a two-week trip to Europe, after Davis's summer term was over. Davis was scheduled to present a paper (co-authored by Hodgetts) at a conference in Spain and hoped to take a break from the business by traveling a bit in Europe. Hodgetts had plans of his own that also took him away from the area and therefore Davis's son Robert was left to represent both Davis and Hodgetts' interests while they were away. Both signed proxies giving Robert the formal authority to act on their behalf. Robert was slightly older than Russ, had worked as a paralegal, and was currently the administrative assistant to the chief financial officer of the local hospital. Robert had originally planned to tour Europe with his parents but opted to use his vacation from work to stay home and mind the business. Robert scheduled a luncheon appointment with each of the subcontractors during the time his parents were away to give him a chance to connect with all of the subcontractors and catch up on events.

The two weeks in Europe were quite blissful for Davis and his wife—they received no emergency calls, kept in touch with Robert via e-mail, and enjoyed the scenery and wines of Spain, Portugal, and France. Hodgetts was also well rested, having spent time away from work gathering background information for future writings and enjoying some time off from his intensive writing schedule. When they came back from their respective breaks they found the following e-mail from Robert:

From: Robert Davis
To: Stephen Hodgetts
Cc: Dad, Ma
Subject: Updates

Just thought you should be aware of some things that are going on and issues that will be addressed today.

After spending a week at the helm of the business while my parents were out of the country, I became very aware of some issues that were going on within the company.

I know for a fact that the situation with Russ is getting worse by the day. I had lunch with Wilma on Thursday, during which she reluctantly provided some rather distressing information about his behavior on the site (in front of her children in a few cases). After our lunch, I phoned Russ's wife and left a message asking to have lunch with her the next day to get her perception on how things were going with scheduling and the progress on the houses. (I mentioned nothing of my meeting with Wilma). Somehow, however, this all got back to Russ. The fact that I was speaking to others outside of him caused him to become quite agitated. He proceeded to threaten Alan and Wilma (in front of his own wife) saying that no one was to speak to anyone but him and that he would report any information necessary to either myself or my parents.

I was not aware of this particular incident as it was happening, but I did quickly become aware that something had happened because Wilma called me a few hours after our lunch (post-threat) and in a very shaky, scared, and (like a witness to a mob hit) begged for me to forget everything she had told me. She rapidly denied what she had said and told me not to breathe a word. Instinctually, I knew Russ had gotten to her somehow (I didn't hear about the threat until Saturday—two days after the fact when everything was calmer). I've had enough experience in life to tell me when someone has been threatened. At the time I didn't know what had happened, but I knew without a doubt something had taken place.

I bit my tongue, however, and fought off all my immediate impulses to find Russ and bluntly tell him that I will speak to whomever I damn well please, that I will talk to everyone to get the whole story on everything that goes on with this project, and that he had no right to address one of our dearest subs in that fashion. But as he seems to feed off of confrontation, I stayed calm and quiet.

Meanwhile, I have heard things from some of our subs (our carpenter, particularly irritated by our horrible scheduling that caused him to wait four hours to complete his tasks on our first home). They are not happy—no matter what they tell Russ to his face, and what I hear behind the scenes is not pleasant.

I received calls from Russ almost daily telling me things were ok, but when I checked in with other people, that's not what I'm told.

I have to say that I am beginning to feel uncomfortable around Russ. The way he keeps his wife silent. The speed at which he responds when I talk in confidence with other persons within the group to keep them from contacting me again.

The instinctual discomfort I felt when I was standing by him and he was holding a hammer like a talking stick (though I knew he wouldn't hit me, I still felt like I should stand out of arm's reach). All of this is disquieting to me.

I have tried to remain as neutral a presence as possible. I have always tried to keep a polite, professional attitude around them. I have invited his wife to lunches, to celebrations, and to chat. And the thing that really gets to me is that she will only engage if she has his permission.

This is not a healthy arrangement. I now liken him to a cancer within the group, slowly eating away at the strength, integrity, and unity that were first present in our team...except that now we're not a team at all. We are a series of single units coexisting to bring this project to an end.

This saddens me as I felt (and still feel) this project, this company, this idea is a wonderful brain child that should not be coerced to continue. The joy and prosperity it has the potential to bring is extraordinary. But, sadly, there is one piece that is acting as the broken link in this dream and it needs to be taken care of immediately. I don't know how; I just know that it must be soon...for everyone's sake.

Please understand, I do not enjoy making these statements. I wish to see everything work out for the best. But, try as I did over this past week to make everything better, I fear that I did not do enough to keep it from getting worse.

The houses are wonderful, but the company is strained. I quietly wish that there was something I could do to make it right. But this is beyond me. My suggestions have been: (1) move Russ to a subcontractor role where he does not have the possibility of asserting false authority; (2) Richard (dad) must be on the site more frequently to observe the progress and interactions first hand (everyone has said that things are better when he's around, so therefore it only makes sense that he make his presence a more common sight); and (3) we need to assert again and again the rules, job descriptions, and ideals of this company. There must be no doubt who we are and what we are here for.

Thank you for allowing me to rant in my report in such a lengthy fashion. I do feel these issues must be brought to light and acted upon. I'm sad there is nothing more I can do to make this better.

Sincerely

RD

Dissolving Partnerships (Part B)

The die had been cast and the sisters of fate, with scissors poised for action, awaited the time of the cutting of the thread. It was July 2003 and Hodgetts and Davis reluctantly agreed that they needed to rid themselves of their co-owner, Russ, given the negative reports they had received from their subcontractors and business associates. Russ's arrogance, coupled with his threatening approach when dealing with subcontractors, made him an immediate liability that would quickly blow up in their faces. Both Davis's wife and son found Russ's behavior intolerable; evidently these behaviors were not going to be corrected in the near term. Davis was forced to choose between his family and his business partner and his business partner drew the short straw.

Davis was especially disturbed, since Russ was a former student of his, and hoped that he could have mentored Russ over the long term of the business and groom him to take over both businesses (D&H Management, DHR Construction) when he and Hodgetts retired (within the next five to ten years). Such was just not to be the case. Davis currently did not have the time necessary (given his teaching and office responsibilities) to provide Russ the day-to-day supervision he apparently needed to properly run the business and it was evident that Adrienne could not serve in that capacity. Without coaching and counseling from Davis, a business meltdown seemed imminent if Russ were to continue to stay involved in the business.

The Dagger Is Drawn

It was during one of Hodgetts and Davis's friendly weekly gatherings, a custom that now included family members and subcontractors from the business, that they both decided to adjourn to a separate room in Davis's house to discuss the matter discretely. Hodgetts had just finished describing a possible twist ending to their co-authored book *The Bard Meets Sherlock Holmes* and was intently listening to Davis's reaction, which of course was delivered in the tradition of the great detective. "I never get your limits, Hodgetts. There are unexplored possibilities about you.[7] At present I am, as you know, fairly busy, but I propose to devote my declining years to the composition of a textbook which shall focus the whole art of detection into one volume.[8] You, my dear Hodgetts, have captured the essence of that art in the last chapter and are to be congratulated for a marvelous piece of work."

"Thank you, thank you," replied Hodgetts. He was smiling from ear to ear and Davis could tell that Hodgetts was very pleased with himself and with Davis's response to Hodgetts' work. Hodgetts had never taken on such a heavy portion of the work load before in their co-authorship and hoped to satisfy Davis's high standards. "I wish that we could deal with Russ as easily as Mr. Holmes dealt with the Bard imposter in Chapter 7. For now is the winter of our discontent.[9] We have seen better days[10] and what is done is done.[11] For to mourn a mischief that is past and gone is the next way to draw new mischief on.[12] So, brave Richard, how might we draw this dagger from our chests?"

Richard Davis had switched his mindset into business mode and dropped his Holmes persona. "This is quite difficult for me as you well know, Stephen. Russ was a student of mine and I encouraged him to become involved in our business. I thought I knew him and clearly I have misread his character. I know that I'm not to blame but I can't help feeling somewhat responsible for Russ—maybe he just wasn't ready to take on such an important position. We must understand that we are in essence not only losing a fellow owner but also firing our building contractor. In any event, I think that we should make him a very nice offer, one that is beyond our ownership agreement."

Davis continued, "Between the two of us we have the majority of shares and therefore Russ has no choice but to leave the company if we so vote. If we were to dissolve the corporation or buy him out, the contract reads that we'd split the company's equity based upon our ownership. That being said, Russ would receive 25 percent of $30,000 ($7,500) minus the salary he drew on this upcoming home building project."

"I have no problem offering him a little more money than he is due," concurred Hodgetts. "What did you have in mind in terms of a buyout settlement?"

Heart of Gold

"First" responded Davis, "I would like us to buy his architectural designs for the homes we've built. We have four separate designs, at $1,000 apiece that's $4,000. I would also like him to have the special plotter which DHR bought which prints the architectural plans, that's worth another $3,000." "That sounds quite generous," quipped Hodgetts. Hodgetts was about to continue about the virtues of generosity when Davis interrupted him.

"I'm not done. I also think that we need to help Russ start his own construction company. We owe him that much. He is the one who introduced us to all of the subcontractors and he certainly was instrumental in getting this business started. I suggest that we help him finance his business, more specifically, I would like us to countersign any loans that Russ would have to take out to build his first three homes. This would include real estate and construction loans. There is no way that Russ could swing these types of loans given his current credit situation. Remember that one of the homes that we are building is his and his money will be heavily tied up in that home."

Hodgetts was silent and Davis knew that this was not a good sign. Hodgetts had been playing banker for the company, his major role in the building projects, and was very cautious as to how the firm's money was spent. Davis expected a very snide remark, undoubtedly a quote from the Bard about being neither a borrower nor a lender, and was prepared for the worst. Hodgetts, who was normally as predictable as the tides, threw Davis for a loop. "An excellent settlement package" Hodgetts said with the greatest sincerity. "What did you have in mind in terms of lending rates? I would like us to make one percent over our own borrowing rate plus 2 percent of the profit from each house. Considering that we usually plan a 20 percent profit margin, I don't think 2 percent is being too greedy."

Davis was impressed with Hodgetts' easy concurrence and thought that the old boy might actually have a kind streak in him after all. "It's settled then," Davis remarked. "I'll set up a meeting with Russ so that we can go through the entire settlement proposal. I know that we're being overly benevolent but I think that we're making him an offer that he really cannot refuse."

"Perhaps," Hodgetts interjected, "You might meet with him alone, one on one so to speak. This is a very delicate situation and I think that you should break the news to him gently, teacher to student, where Russ won't feel overwhelmed by both of us putting pressure on him. He needs to understand that we have voted him out of the business but that we are offering him far more than his fair share. He also needs to understand that we are not only doing this for the good of the business but for his own good as well." Davis and Hodgetts agreed on this tactic and then rejoined the get together of subcontractors and family members.

Davis's Meeting with Russ

It was a busy week for Hodgetts and Davis so Hodgetts was not surprised when he received the following e-mail from Davis:

Sorry I did not get back to you sooner on the events of Monday and today. On top of everything else, my allergies are kicking in like gang-busters and I just want to hibernate! Anyway, yesterday's lunch with Russ went well. I did not share with him any written proposal or agreement, because I wanted to go through the issues first, gain agreement, and then go to more official documents. I approached this from the point of view that he and the two of us are going in different directions, both in terms of the short term (management style) and longer term (he wants to become a developer, and at least I don't). I suggested we begin to break up the company with him using his own LLC as a vehicle to construct three homes, with our financial backing. At the end of lunch (1 1/2 hours) we were on very good terms. He admitted that he thought I was going to fire him, and I tried to reassure him that wasn't the way I work. I'm a problem solver, not a problem maker. He seemed more relieved than anything.

Today I met with Russ out on the site for another hour. He had had time to think and talk it over with his wife and had some more questions. He is concerned about three things: (1) the salary issue, which I said I hadn't had time to process yet, but since salary would be coming out of his equity position, we could buy him out and give him the cash up front (he seemed interested); (2) how he could move forward on three homes, build and sell them in a short period of time; and (3) he really does not want to cut ties with you or me—and he is offering to teach me everything he knows about the management side for some sort of management fee.

Initially, he said we could pay him an 8 percent management fee, but I said that was half our profits and that would never fly, so he backed way off. I know Adrienne will go ballistic if we entered into any sort of management agreement for one or two years, so I said to Russ that I'd need to think about it and chat with you. But overall, he is in full agreement with our decision. I've made it crystal clear to him that he is not to give Alan or Wilma or anyone else any direction, criticism, or his wisdom—all of that is to go through me now, and he has fully agreed.

I think he is basically a good kid. He's still a bit immature and has an anger problem, but I don't doubt his sincerity or honesty. This is the right decision—for him to move on and for us to go our own way, but I don't think it has to be based on rancor or pettiness. I'm trying my best to keep personalities out of the discussion and focus on future directions. I've got several hurdles to overcome with Russ and with Adrienne before we get to a final agreement, but I think a full separation is at hand. I just want to do it gently—this will take more time, but I think everyone will benefit in the end.

Hodgett's e-mail reply was succinct and to the point:

You handled this very well and you made him a generous offer—more than I would have to begin the discussion. Your initial offer puts cash in his pocket, about $15K from what I remember, and that should be equal to three months of living expenses. Since we will be helping him on the financing side of his first three homes then what does he need more cash for? I want to help the guy but we have to be very careful about our own cash flow and our own needs—like paying ourselves back our initial investments and paying me back on my short-term loans!

In terms of him working for us, in all candor, I do not know if we want any of his wisdom since it comes with a heavy price—I would rather pay for you to take a course on home construction or hire someone else. We need to distance ourselves from him ASAP if we are to keep your wife and the subcontractors on friendly terms.

The End Is Near—Or Is It?

Davis, Hodgetts, and Russ met for breakfast in August 2003 to finally iron out the buyout agreement.The meeting went very well, with the agreement including all of the extras that Davis and Hodgetts had discussed and excluding any side agreement with Russ for consulting services. Russ was to continue supervision of the building of the three homes that were near completion, and that he was drawing a salary from, but was excluded from all other building sites of DHR Construction. Everyone left with a signed copy of the agreement, hand shakes, and a feeling that all had been settled. But had it?

In Hodgetts and Davis's next weekly meeting, it became plain that events were not transpiring as planned. "Russ still pokes his nose in where it doesn't belong, but I tell people to ignore him," Davis commented. "The latest, he told Bob the painter he couldn't paint the Wexford, one of our new homes, this weekend because the door wasn't in yet. I told Bob to ignore Russ and work on our schedule. I don't know what's wrong with this kid. He just doesn't get it."

"He doesn't get it, does he?" replied Hodgetts. "Perhaps we need to remind him that it is a breach of contract to visit our sites, especially those he is not involved with, and that we would be more than happy to go back to the original agreement of merely splitting the assets from the three sales. Has he started to work on developing his own projects? If not, it may be a good idea to have a quick wake-up call with him. He needs to be reminded that he needs to concentrate in getting his own business off the ground. The clock is ticking since in our agreement, we gave him six months in which to use our financial support."

Several weeks went by and the situation was worsening. Davis was livid and did not mince words with Hodgetts. "Regarding Russ—I'm going to be buying a gun this afternoon. The delightful boy is hot on the rumor mill, and is trying to sabotage us. He told Keith at West Point Interiors (that's our carpet, tile guy) that we're bankrupt and going out of business and that I'm firing our employees before the end of the week. He's told our other subs pretty much the same things and they're all upset. My wife is making cookies and I will meet with all the subs this afternoon and dispel this one. I think he's psychotic.

I am also meeting with the other David, our mortgage specialist, at 1p.m. today to specifically discuss Russ. It turns out that Russ's credit scores have plummeted, and he no longer qualifies for a mortgage. I know Russ wants us to buy the place we are building for himself and then lease it to him with the option to buy, and we probably will, since that house is going to be hard to sell to someone else. I was supposed to meet with David Russ this morning, but was so depressed that I couldn't get out of bed, so I'm meeting with him on Friday for a real come-to-Jesus meeting. Threats will be involved.

You and I have *not* signed any guarantees for Russ on his new ventures, and I'm thinking of withholding them based on all this going on. Getting stuck with his house is bad enough, but getting stuck with three more would be beyond my tolerance.

In the interim, Russ has hired a lawyer to try to renegotiate the deal that had already been signed and agreed on, most specifically dealing with the issue of how Russ was now not able to obtain financing for the home that DHR Construction was building for him."

Hodgetts was shocked, not only at the turn of events but how his colleague had become so incensed about Russ. He responded in a like, harsh tone. "I have no qualms breaking our agreement with Russ if we can document that he has interfered with our business (i.e., spreading these rumors, showing up at our work sites). There is a law against slander and I think he needs to be reminded that he is responsible for his actions.

In terms of his house, if he cannot qualify for a mortgage, then he should ask his parents to cosign the loan for him. I really do not want to enter any business deals with Russ and would much rather sue him if he is going to breach our contract about the house. How is he going to make rental payments? In all candor, I can be a very spiteful guy if someone tries to screw with me and my partners. I would be happy to just buy his house outright (at our cost), rent it, sell it, or just own it as a second home. If we get stuck with his house, my feeling is that we have satisfied our agreement with Russ and that he is on his own. Boy, is this kid self-destructive! Looks like he wants to get punished! I wish I could be at the meeting on Friday but as you know I have my two classes to teach."

Yee Gods, What Was That?

The meeting in late August with Russ went as Davis and Hodgetts expected. Russ denied the spreading of rumors to Davis while Davis reminded him that any of these actions violated the noninvolvement clause in the originally signed contract. Davis also reminded Russ that he was responsible for the cost overruns in his own home and that those overruns would come out of his profits from the eventual sale of the home.

A few days later, in early September, Hodgetts received the following e-mail from Russ:

> I wanted to first take the opportunity to tell you thank-you for giving my wife and me the opportunity to be part of DHR with you. It is unfortunate that it didn't work out the way we had originally planned. Things here have been pretty good. I don't know if you have heard yet or not. I had to pull out of the house. Due to us being self-employed and my wife not having a job due to student teaching this semester, the mortgage company's rate changed and they were saying that the mortgage would be around $1,600 per month, which we couldn't afford. So we decided that we would go a different direction in regards to a house. Currently we are living with my parents until January.
>
> On another note I was wondering if you would be interested in investing in my new company privately outside of DHR and Richard Davis. Right now I am looking to raise 20 to 25 percent of the building cost for the bank to give the loans to me in my own name. I have worked up a promissory note, which states that I would return to you in six months the initial sum along with a 10 percent return. The one house I am currently seeking money for would need an investment of $50,000. This house is a 1,265 square foot house, which will be built in the Westridge Village subdivision, which is where I was initially going to build my house. The community in which the homes will be built in will be a maintenance-free patio home community. They all have rear loaded garages and large front porches. Each house is designed in a 1920s cottage/craftsman style. If you could please e-mail me or call me and let me know if this sounds like an investment you would be interested in, I would appreciate it.

Simultaneously, Richard Davis received a similar e-mail:

> I'm sorry that I haven't been able to get a hold of you on the phone the last couple of days. I wanted to talk to you before the letter got to you. However I was unable to reach you. I wanted to take the opportunity to thank you for all that you have done for my wife and me. I am sorry that our original plan never got to where we wanted it to. I also wanted to wish you the best of luck with DHR Construction, LLC. I also wanted to see if you were still interested in guaranteeing and providing the 20 percent for the land as was originally discussed for my first project. If you are, I would like to treat it as a private investment in which I would pay you your original investment plus 2 percent of the total sales price as was previously agreed upon. If you are unable to do so, I understand completely. I am currently working on a contract that will layout the agreement for the investment. I have sent you a hard copy of a similar letter in which I have enclosed the corporate credit card and the keys to the houses DHR is building. I mailed them to your office. If you could please get back to me regarding the properties either via e-mail or by phone, I would greatly appreciate it.

Hodgetts immediately replied to the e-mail, blind copying Davis.

> David:
>
> Thanks for keeping me informed as to your plans with your own construction firm and I appreciate your contribution to starting up DHR. I understand that the mortgage on your house is quite high and that you cannot afford to buy this home—any suggestions for the disposition of this house to recoup the costs?
>
> I am honored by your invitation to become involved in your business. What I do not understand is why would you need these start-up funds in the first place? Davis and I signed an agreement with you that said that we would be cosigners on your next three projects provided that they started within the next six months.
>
> Maybe I've been out of the loop and I have missed something—let me know what you think.

Davis also responded to Russ's e-mail and blind copied Hodgetts. He took a very different approach:

> David:
>
> You have put me in a very, very awkward position. You gave no indication of problems when you, Stephen, and I met for breakfast, and signed the breakup contracts so I was extremely surprised when I got the letter from your lawyer wanting to renegotiate the deal. I have no idea why you felt you had to go that route to solve problems you had not alerted Stephen and me to, but it was your choice. Simply, what you have now done is put our relationship in the realm of attorneys. All agreements from this point on will have to be done through our attorneys. I have instructed my attorney regarding our official response to the request for renegotiations and the conditions that will best serve DHR Construction, LLC, and will await a response from your attorney. I hope we can come to a final agreement very quickly.
>
> Regarding further investments or guarantees for your new real estate business from me, based on the events of this last week, I am surprised you would even ask. I continue to wish you the best of fortunes and I sincerely hope you will be successful, as I have said all along. Exactly what my help to you could/should be at this point deserves some very careful consideration, which I will do.

O.K. Genius, Now What?

Davis and Hodgetts had tons to talk about at their next weekly meeting. Davis, brandy in hand, immediately launched into a vigorous discussion of the Russ situation. "Just when you thought it was safe to go back into the water…The guy's delusional! Not only does he not share any of his thoughts with me on his problems with the breakup, but then he pulls this stunt! I assume you're playing with him, Hodgetts, you can't be serious about investing in him I'm sure."

Hodgetts allowed a few moments of silence to elapse before he reacted. He could see that Davis was actually tensing up and Hodgetts could barely keep himself from breaking out into hysterical laughter, no less keep a simple smirk off his face. He had known Davis for a long time and this was the first instance he could actually remember being in a position to play a serious trick on his good friend and colleague. "Well you know that the offer is quite tempting," Hodgetts lightly remarked. "You keep telling me how I need to diversify my investments. Perhaps I should give Russ's proposal earnest consideration—I could even negotiate for partial ownership of this new venture!"

Davis, usually the cool, calm, and collected partner, was turning several lovely shades of red when Hodgetts could no longer contain himself from bursting out laughing. "Of course

I'm playing with him! How could I not follow this to its most illogical conclusion? Our new book which I have just outlined, *The English Professor Turns Capitalist,* states that a moral capitalist allows all irrational behavior to be treated as humanely and kindly as possible—Russ has built his castle in the sky, why shouldn't I let him live in it for awhile? I'm just wondering how far I can carry on this farce until he realizes that I'm not serious.

I must admit that I read his e-mail with real amusement. He must know that any information that he sends me I will share with you and vice versa. Unless, of course, he wants you to know that he's made me an offer. Does he think he can drive a wedge between you and me? Secondly, does he actually think that I would fund a competitive startup venture to DHR Construction?"

Davis poured himself another brandy as he pondered the situation. "Russ must be in serious trouble to ask us both, independently, for assistance. I thought he may have found another investor to shore him up and that's why he decided to renege on our contract. Apparently not. He acted before thinking (as if that's something new) and he's starting to realize the consequences. He's now scrambling for an investor if he's desperate enough to contact you and me in this way. Frankly, if you and I refuse to guarantee his loans, he's probably screwed. He's still sending out rumors that I am a bad manager and that on his own he can build 100 homes a year. The guy needs a very strong dose of reality. I'll be interested in his next contact with you—there will be no contact with me."

Hodgetts was a bit taken aback by Davis's last comment since Russ was a former student and Davis had gone out of his way to bring Russ into DHR Construction. Hodgetts had set his brandy down during the entire discussion and finally took his first sip—he needed to steady himself before he ventured into his next line of commentary. "I think that Russ is waiting to see what you and I will do in terms of his offer and perhaps hopes to play us off against each other. I'm curious if he'll come back to me with a counter offer, or if he'll contact us through his lawyer again.

I must admit, however, that I am tired of these games. We need to take positive actions now that we have permanently and forever severed our ties with Russ." A few more sips of brandy and Hodgetts fell back into his old habit of quoting the great bard, William Shakespeare:

> *When we mean to build, we first survey the plot, then draw the model; and when we see the figure of the house, then must we rate the cost of the erection.*[13] *But O, what men dare do! What men may do! What men daily do, not knowing what they do!*[14]
>
> *What's gone and what's past help should be past grief*[15] *for to mourn a mischief that is past and gone is the next way to draw new mischief on.*[16] *Yet a crafty knave does need no broker*[17] *for time shall unfold what his plaited cunning hides.*[18] *Come what come may, time and the hour runs through the roughest day.*[19] *What else seest thou Richard in the dark backward and abysm of time?"*[20]

Davis, who would normally respond to Hodgetts' play acting through the persona of the great detective, Sherlock Holmes, decided to quote from Scott Adams' beloved cartoon *Dilbert.* "Stephen, I can please only one person per day. Today is not your day. Tomorrow isn't looking good either.[21] What I need from you now is a list of specific unknown problems that we will encounter.[22] Intelligence, as you might have guessed, has much less practical application to our problem than you'd think."[23]

Both Hodgetts and Davis chuckled at Davis's acerbic response. Their pedantic play seemed more like the Bud Abbott and Lou Costello routine "Who's on first?" than a serious conversation. Both knew that they had a real problem on their hands that neither one really wanted to deal with. It wasn't a matter of who was on first but "what do we do now?"

Editors' Note: Anyone wishing to obtain the instructor's manual for the case study should contact Dr. Herbert Sherman at Herbert.Sherman@liu.edu.

Endnotes

1 The names of the companies and individuals in the case have been changed as per the owners' requests.

2 http://www.bcpl.net/~lmoskowi/HolmesQuotes/q.creed.html, March 23, 2004.

3 We would like to thank the reviewer for indicating the need to discuss Stephen Hodgetts', Richard and Adrienne Davis's managerial experiences with their rental business as well as David Russ's previous work experience.

4 Dingee, A. L. M., B. Haslett, and L. E. Smollen. 2002. Characteristics of a successful entrepreneurial management team. In R.W. Price (ed.) Annual Editions: Entrepreneurship 02/03. Guilford, CT: McGraw-Hill/Duskin, 100–104.

5 We are indebted to the reviewers for their observations and comments.

6 Most construction loans were based on a percentage of construction costs, not assessed value, and therefore required at least 20 percent out-of-pocket expenses for the builder excluding land costs.

7 http://www.bcpl.net/~lmoskowi/HolmesQuotes/q.Watson.html, October 13, 2003.

8 http://www.bcpl.net/~lmoskowi/HolmesQuotes/q.detection.html, October 13, 2003.

9 http://absoluteshakespeare.com/trivia/quotes/quotes.htm, October 14, 2003.

[10] Ibid.
[11] Ibid.
[12] Ibid.
[13] http://www.bartleby.com/100/138.18.html, November 19, 2003.
[14] http://www.allshakespeare.com/quotes.php?id=336, November 19, 2003.
[15] http://www.allshakespeare.com/quotes.php?id=344, November 19, 2003.
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[18] http://www.bartleby.com/100/138.33.html, November 19, 2003.
[19] http://www.bartleby.com/100/138.31.html, November 19, 2003.
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[21] http://users2.ev1.net/~fkubat/sayings/b/sayb56.htm, November 19, 2003.
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About the Authors

HERBERT SHERMAN (Herbert.Sherman@liu.edu) is a professor of management and program coordinator of the business and accounting program at Southampton College–Long Island University (New York). He received his Ph.D. in strategic management from the Union Institute and University in Cincinnati, Ohio. Dr. Sherman teaches undergraduate and graduate courses in management and marketing strategy. His research interests include business strategy, case writing and research, and education administration. He has published his work in several journals, including *Journal of Management Science and Policy Analysis, Entrepreneurship and Regional Development, Case Research Journal, Management Decisions,* and *Planning for Higher Education.* Dr. Sherman recently coauthored a book entitled *Supervision in Colleges and Universities* (University Press, 2004) and is completing a coauthored textbook in strategic management with the same coauthor. He is the currently editor of the *Case Journal* and the former editor of the *Journal of Behavioral and Applied Management.*

DANIEL JAMES ROWLEY (daniel.rowley@unco.edu) is a professor of management and chair of the Management Department at the Monfort College of Business at the University of Northern Colorado. He is the lead author of four scholarly books on strategic planning in colleges and universities; a workbook in the same series; a book on academic supervision; and a forthcoming textbook on business strategic management with Dr. Sherman. He is the author of articles and presentations on these subjects nationally and internationally. He has served as editor and as associate editor of the *Journal of Behavioral and Applied Management,* and has published book reviews and article reviews in several different journals. He received his B.A. from the University of Colorado at Boulder in 1969; his MPA from the University of Denver in 1978; and his Ph.D. from the University of Colorado at Boulder in 1987.

From the Practitioner's Corner

No Mulligans: When Good Entrepreneurs Make Bad Decisions

Joseph E. Levangie

Some of the best entrepreneurs fail early and often. Less talented or less committed entrepreneurs do not even get a second chance. Failure and setbacks, however, can be instructive. What lessons can be learned from these experiences? How can the entrepreneur (and investors) navigate around the potholes on the New Venture Highway? Read on.

It was reported that on a Nova Scotia fishing trip many years ago, Ted Williams, the Boston Red Sox star hitter, and Sam Snead, the standout golfer of his era, entered into a conversation concerning the relative difficulty of their two sports. It went something like this:

> Teddy Ballgame: "Sam, golf is easy. The ball just sits there on the ground. When you're good and ready, you hit it! In baseball, I face a pitcher slinging the blurry white pill at 95 miles-per-hour! And I don't get any second-chance Mulligans like you golfers!"
>
> Slamming Sammy responded: "Ted, every time you hit a foul ball, you are really getting a Mulligan! You get to hit the next pitch. In golf, we have to hit our foul balls from wherever they've landed!"

While I've personally attained certain levels of incompetence in both sports, I know from my entrepreneurial activities that we can draw two object lessons from this classic conversation. First, it is generally moot to compare one particular challenging venture directly to another; a single dissimilarity can outweigh all points of commonality. Second, unless you cheat or passively await divine intervention, there are no Mulligans in entrepreneurship to help you succeed. You should intend, therefore, to meet the rigors of conceptualizing, implementing and operating your new business venture without the benefit of "a free pass". In this Age of Entitlement—a term coined by Robert J. Samuelson (1996)—increasing numbers of people seek the easy path. There are few entitlements, however, for small business, and the entrepreneur should look in the mirror for self-help. Entrepreneurship requires serious, well-focused endeavors and an enormous amount of blood, sweat and tears! Good decision-making entails all that effort—plus unbiased and intelligent sorting of alternate actions.

The statistics of success in decision-making suggest that entrepreneurs face daunting odds. In the chaotic world of venturing, you are expected to be near perfect. You must succeed at each step of the business development journey. Ted Williams, by contrast, failed to get a hit more than 6 times out of 10. At each hole, Sam Snead generally needed 3 to 5 shots to get the ball in the cup. Sports metaphors undoubtedly trivialize the plight of the would-be entrepreneur. In striving to be near perfect, entrepreneurs confront a series of complex tasks: planning, product/service development, marketing, financing, operations/organization building, and sales.

The road map for a new venture can be depicted by a complicated, occasionally impressive, decision tree that sequences these tasks in a cascade of branching actions and outcomes (Ulvila and Brown 1982). The underlying logic, thankfully, can be simplified. If the conditional probability (i.e., conditional upon the previous venture stages being successful) of each of these six stages is a respectable 80 percent, the probability of success is only 26 percent (0.8^6)! Not good enough for many early-stage investors. Improving each of the conditional probabilities to 90 percent produces a 53 percent probability of success. You'll still fail half the time! Success and bad decisions obviously don't mix well!

Dilemmas Influencing Decision-Making

When we analyze how small business CEOs make choices, we are reminded that in the hierarchy of decision influences, survival heads the list. Staying alive, however, cannot be taken for granted. Risk abounds. Small business continues, nevertheless, as an important subset of a dynamic economy.

Small and emerging companies contribute both job creation importance and volatility to our economy. The Wall Street Journal (Bounds 2004) recently culled some data from the Small Business Administration that underscore the extent to which small firms permeate, if not dominate, the U.S. economy.

Small businesses:
- employ half of all private sector employees;
- generate 60–80 percent of all new jobs annually; and
- pay 44.3 percent of total U.S. private payroll.

Life cycles of business births and deaths in 2003:
- business births—572,900

- terminations—554,800
- bankruptcies—35,037

The real dilemmas an entrepreneur faces in decision-making—which can ultimately threaten his survival—involve all the usual factors: external factors beyond the firm's control; competition; financing difficulties; operational problems; personal problems of the entrepreneur; and calamities, including fraud, natural disasters and theft.

External Factors

The entrepreneur has little control over external factors. His (or her) decisions should be crafted, however, with an informed sensitivity to the company's changing environment. A few years ago, when the dot.com bubble burst, thousands of development stage companies were swept under in its wake. Dozens of New England companies canceled or postponed their IPOs. Many entrepreneur-investors took a severe financial "haircut," laid off people, closed operations, watched loans go bad and, at not an insignificant cost, acquired new-born humility. Diminution of personal net worth aside, the rigors of an economic downturn can introduce much needed discipline to the entrepreneur. The dilemma of a nasty business climate has, ironically, reintroduced old basic concepts such as "bootstrapping" and "moonlighting" (Denison 2000) to venture decision-making. The harsh reality requires the entrepreneur to squeeze incremental value out of scarce available resources. This renewed discipline serves well to remind CEOs that the crazed days of investors throwing funds at deals is history; that party is over and it's time to sober up!

In addition to the vicissitudes of the economy, there are other external decision-making challenges for the CEO imposed by new regulations. An important regulatory example is the ever-present Sarbanes-Oxley (S-Ox) with its requirements for improved corporate governance. Berry (2004) reports that while presently only public companies need comply with S-Ox regulations, it is possible that some offshoot of S-Ox will ultimately apply to privately-held firms as well as not-for-profits. The real decision tree for the entrepreneur is whether to become S-Ox compliant now, or wait until the rule extension is imposed; and how to craft an exit position for investors—be it an IPO or a buy-out by a publicly held company. In either case S-Ox compliance will be necessary. Still, I find many entrepreneurs staunchly resisting S-Ox under the guise that compliance is expensive and they're saving money. It is like the old Fram oil filter commercial—"You can pay me now or you can pay me later!"

Competitive Factors

An enlightening acid test to see if an entrepreneur really knows his business is to ask, "How do you rate your competition?" Having interviewed well in excess of a thousand entrepreneurs over three decades, I would assess—anecdotally—that a full third of these would-be captains of industry give a knee-jerk response of "Oh, we really don't have any competition!" Wrong answer! The essential dilemma is that the company's strategic decisions cannot be made in a competitive vacuum.

If one learns nothing else in an MBA program, one should remember to address strategic issues by employing the venerable notion of SWOT—Strengths, Weaknesses, Opportunities & Threats. *CFO Magazine* reports (Durfee 2004) that the typical reaction for CEOs is to use half of SWOT—to focus on the positives of the external business environment and to deemphasize the negatives. When bad things happen to these good entrepreneurs—say the flop of a new product launch—it is not credible for them to blame "bad luck" if the risks of competitive threats have not been considered. The better you analyze critical decisions, the better your "luck!"

Over the last 25 years, the reigning guru of competitive analysis has been Michael Porter of the Harvard Business School, supplanting the Boston Consulting Group with its "experience curve" ("profitability is directly related to market share"), so ballyhooed in the '60s and '70s. Warsh (1994) reports that Porter imputes four competitive forces impacting the profitability of an industry:

1. rivalry among existing firms;
2. the bargaining power of both buyers and suppliers;
3. the threat of new entrants to the business; and
4. the threat of potential substitute products.

Porter introduced the "value chain" framework of interrelated marketing functions (customer base, brand name, distribution, service). The value chain contributes to the strength of a firm's product presence and calls attention to the competitive advantages that many big companies enjoy. Entrepreneurs, who often view big firms as outmoded dinosaurs, need to assess realistically the competitive risk of all market participants in the marketplace—including large firms—in the course of strategic decision-making.

How does the enlightened entrepreneur discover more about the competition? While there are no Mulligans in this arena, there are ways to improve your odds. Caulfield (2004) reports that initiating the proper due diligence is key. The right "course management" involves culling data from the public domain, overlaying your knowledge about your own company with that of the industry, and connecting the dots to draw patterns. Specific steps include:

- Research easily accessible databases to determine competitors' health.

   - Check competitors' Securities and Exchange Commission (SEC) quarterly and annual filings at www.sec.gov to find product line margins, customer base, research spending, and personnel background.
   - Check competitors' credit with Dun & Bradstreet, which will sell you detailed reports for $122 each.
- Creatively dig up important competitor information.
   - Attend professional courses taught by competitors' management which might reveal their private financial and marketing information.
   - Access competitors' presentations to analysts at investment conferences and on conference calls which might represent the informational mother lode (e.g., I once plugged into the conference call of my biggest competitor, asked a question, and obtained an answer that swayed a critical strategic decision of our emerging company!).
   - Check the Help Wanted pages to see if competitors are hiring; and if so, what kind of technical skills they are seeking.
   - Analyze your foes' web sites. Email some queries to the web master—who knows, maybe he will spill the beans on something important and proprietary!
- On the defense, assume that turnabout is fair play.
   - Be careful to screen all your company's web site postings, press releases, presentations and vendor discussions.
   - Compartmentalize information among your company's different departments. Apple Computer, for example, can trace internal leaks because it assigns different code names to different departments for the same development project.
   - As appropriate, if threatened by overseas rip-off companies, have some fun. If your company needs to file a patent (that works), file several others that do not work and have the foreign firms waste their reverse engineering budget chasing a red herring!

Financing Factors

The area of finance is where the aspiring entrepreneur generally has the biggest dilemma in decision-making. Issues abound.

- How much capital do we need? When do we run out?
- What kind of capital should we seek with what structure?
- Where do we find the investors?
- How much will it cost our ownership in terms of dilution and control?
- What is involved in negotiations?
- How do we close the deal?

A cute ode by DeGarmo (1991) regarding an entrepreneur's quest for funding reflects well the financial decision-making climate:

We were hungry for money, our nerves were all frayed.
To survive, our expenses could NOT be delayed.
In the past our agreements on handshakes were made.
We just did not know how this new game was played

As we battled each crisis of mistimed receipts
We bluffed, we negotiated, made impassioned entreats.
The nights we spent tossing and whipping the sheets.
The days were reserved for strategic retreats.

Now we're losing our stakes, being left with the rinds,
From those equity penalties we shouldn't have signed.
We brushed off our lawyers. We were caught in a bind,
By those last-minute threats: "We're changing our minds."

In late 2004, there is good news and bad news for entrepreneurs as they consider capital raise-ups. The bad news is that while venture capitalists invested $833 million in 74 deals in New England companies in the second quarter of 2004, according to an Ernst & Young report (Witkowski 2004), only 32 percent of the deals involved seed or first round financings. The remainder went to bolster existing portfolio companies. The good news is that venture capital is not the only source of funds. Gennari (2004) reports that of *Inc. Magazine's* 2003 list of the 500 fastest-growing companies, only 2 percent used venture capital as their source for start-up funding, and more than 70 percent were started with $100K or less. Healy (2004) reports that private investor groups, such as the Lexington, Massachusetts, Common Angels, are dramatically increasing their deal review activities. The dilemma for entrepreneurs is how to tap in on these positive developments.

Operational Factors

Peter Drucker (2004) has consulted to business for 65 years. His recent writings address several aspects of the operational dilemma of decision-making. Drucker concludes that successful managers can be "charismatic or dull, generous or numbers oriented." But every effective executive followed eight simple practices:

1. They asked, "What needs to be done?"
2. They asked, "What is right for the enterprise?"
3. They developed action plans.
4. They took responsibility for decisions.
5. They took responsibility for communicating.

6. They were focused on opportunities rather than problems.
7. They ran productive meetings.
8. They thought and said "we" rather than "I."

Drucker explains, "The first two practices gave them the knowledge they needed. The next four helped them convert this knowledge into effective action. The last two ensured that the whole organization felt responsible and accountable."

Entrepreneurs who remain blind to this kind of invaluable advice are far more likely to make decision errors.

Personal Factors

Among the unfavorable traits you might find in an entrepreneur, the following could most negatively impact effective decision-making:

- naiveté;
- arrogance;
- inexperience;
- lack of relationship-building; and
- emotional immaturity.

As chronicled in the article "The Young and the Clueless" (Bunker et al. 2002), such negative personal characteristics outweigh, in case after case, the benefits of being high-energy, intelligent and aggressively hard-working. I regrettably have my own war stories of unfortunate personal traits in entrepreneurs confounding otherwise normal decision-making:

- A London investment banker looked over at our technical founder/CEO and quietly asked me if his secretary might not take our "boy entrepreneur out shopping so the rest of us can complete the financing."
- A cofounder and CEO in one of our technology companies was so emotionally committed to the company's original target market that he could not concur with the board of directors' decision to change direction and target a larger, more quickly accessible, faster growing, higher margin market. Despite being a large shareholder, he defamed the company to Wall Street, and started to spiral emotionally out of control. With an armed guard on premises, the board of directors voted him out of the company. Thankfully, no shots were fired! This entrepreneur's self-destructive decision-making remains, however, a dilemma to many of us, years later.

Calamities, Fraud and Other Surprise Factors

A question for the ages: If fortunes are destined to go really bad for your company, would you rather mess up on your own or have it "done to you?" This dilemma is not really a binary decision since the choice for some entrepreneurs depends on whether the calamity is an act of God (e.g., a flood) or an act of man (e.g., fraud). Some of us can—reluctantly—accept outcomes beyond our control (e.g., the dot.com market bubble burst) far easier than fraud by a trusted member of the entrepreneurial team:

- The CEO of a firm we were acquiring dropped dead only 20 minutes before signatures on the closing documents were to be obtained, thereby aborting the deal (sad, but the kind of busted deal which we can understand and accept).
- The CEO of a newly public development-stage company that we helped sponsor took a two-month post-IPO vacation to Australia on company funds to improve his tennis game after his eight-year struggle to raise funds (fraudulent and unacceptable, of course, leading to his dismissal, and forfeiture of his 40% equity interest).

Watkins and Bazerman (2003) suggest that signals of future calamities generally lie all around us and it is up to us to be astute enough to recognize them. Truly out-of-the-blue surprises aside, these researchers employ a concept called the "RPM process": recognition, prioritization, and mobilization.

- Recognition
  - Marshal resources to scan the environment for emerging threats.
  - Analyze and interpret the data.
- Prioritization
  - Brainstorm the possible surprises.
  - Analyze the cost-benefit of such consequences.
  - Prioritize those threats with the highest costs.
- Mobilization
  - Select the most serious threats.
  - Take precautionary measures commensurate with risks.

The Entrepreneurial Decision-maker

I have always found it fascinating to observe how business decisions are made. Large corporations—to their CYA credit—need to get consultants on board, purchase pricey market research reports, and conduct a seemingly endless chain of meetings. Some sessions may even be held off-site to stimulate the (presumptive) latent, lateral-thinking juices of the management team. Only then can they line up "the right players" to deliver "the big green light" of approval. Time is not usually deemed as critical; in fact, the time needed for a decision tends to be an exponential function of the number of people involved. A sidebar to this contorted decision route is the university setting where some schools actually flaunt their "committee on committees" as a desirable level of faculty involvement in the decision-making process.

In contrast, on dozens of occasions I have witnessed an entrepreneur take less than 90 seconds to make a monumental decision. Often while eating, and dripping pizza slime over an original document for his signature, he will ask a few key questions and say aye or nay. The ramifications of his instant decision might impact 150 percent of the company's cash balance or 30 percentage points in the venture's probability of success. "No matter," says the entrepreneur, "time is of the essence!" He continues eating.

This dichotomy of decision-making approaches underscores a certain conundrum: Can a professional manager become an entrepreneur or can an entrepreneur act like a manager? As O'Neal (1993) reports, even the venerable Peter Drucker skirted this issue in his writings on the subject by disclaiming that he would not discuss "psychology and character traits" of entrepreneurs. O'Neal notes, "While [Drucker's] probably right that the nuts and bolts of entrepreneurship can be studied and learned, the soul of an entrepreneur is something else altogether."

Amen, amen. So it comes to pass I will take a stab at deciphering this quandary of the entrepreneurial soul. Some observers of the scene, of course, believe that certain entrepreneurs whom they've encountered are, in fact, soul-less! The issue facing business schools, for example, is that the principles and mechanics of entrepreneurship can be taught, but the notions of creativity, drive and appetite for risk-taking remain well below the surface.

Prospective entrepreneurs come in all colors, sizes and shapes. Few are obvious daredevils or snake oil salespeople. Not many are impulsive or flamboyant. Most have an entrepreneurial idea and an intense need to exploit that idea "their way." O'Neal (1993) reports on a Purdue University study on why entrepreneurs "take the plunge." Based on 2,995 people who had decided to go into business for themselves, they responded "very important" to the following reasons (approximate percentage responses):

• to use my skills/ability	56%
• to gain control over my life	54%
• to build for the family.	52%
• to pursue the challenge	48%
• to live how/where I like	32%
• to gain respect/recognition	19%
• to earn lots of money	18%
• to fulfill other's expectations	9%
• to follow the best alternative available	7%

One can interpret this underlying motivation for the entrepreneurship life in the framework of decision-making traits, quirks and weaknesses by addressing the following:

- Does the stage of business life impact how decisions are made?
- How do personality and power/control issues impact choices?
- What type of bias creeps into decisions?
- What is the consequence of the decision-making methodology?

Stages of One's Decision-Making Life

Bennis (2004) references Shakespeare's seven ages of man (*As You Like It*) with a remarkable combination of business and literary acumen. Paraphrasing the Avon bard, Bennis applies the following seven stages to the development of leadership, and, derivatively, decision-making:

1. The "infant executive" needs a mentor before he's even given the leadership job. He must recruit a real team to back him up. His decision mistakes are typically from inexperience.
2. "The schoolboy, with shining face" as a first-time leader, is potentially unnerved by the spotlight and scrutiny surrounding his initial words and actions. He senses that he has only one chance to make a first impression. New team members will show either trust or distrust, either support or resistance—yet some of the negative feedback on his decisions may actually be accurate. His errors in decision-making may stem from nervously looking over his shoulder.
3. "The lover, with a woeful ballad" experiences the dilemmas of setting new boundaries in leading his former colleagues. Evaluation of his team's job performance, strategy formulation, and task prioritization can be in potential conflict with his "loving" relationships with his old cronies. His decision errors often emanate from the confusion of changing relationships.
4. "The bearded soldier" becomes comfortable with his leadership position. A danger evolves that he may forget the visceral impact of his words and decisions on his staff. As a result, his team may only tell him what they think he wants to hear. The true leader avoids this communications barrier by being open with his people. He may decide to hire talent better than himself and praise them for their accomplishments, rather than being jealous at their stars glowing perhaps brighter than his. Conversely, the degree to which the entrepreneur might have any self-doubt about his own shortcomings can create a nonrational (and possibly an irrational) decision-making environment.
5. "The general, full of wise saws" becomes arrogant and does not see or hear the dangers around him. Like Shakespeare's Julius Caesar, he does not heed the soothsayer's Ides of March warning or Calpurnia's pleas. Arrogance can keep the "general" from building alliances and coalitions in his senior team that will pro-

vide him with valuable input and the "reality check" he needs for his difficult decision-making. He lectures a lot, listens little.

6. "The statesman, with spectacles on nose" is in a position to pass on his wisdom without worries of personal ambition. For short periods of time, the statesman can be quite effective in making important and difficult decisions without personal career considerations.
7. "The sage, second childishness" is the older mentor who wants to create a legacy by imparting knowledge to a younger generation of entrepreneurs and to provide structure for more mature decision-making. The sage reminisces, orates and teaches.

One of my all-time favorite business shrinks, Abraham Zaleznik (1967), penned the following, back when I was a mere youth in his first-year HBS class:

> *One of the major contributions of psychoanalytic psychology has been to demonstrate the place of conflict in the development of the individual. Each stage in the life cycle involves personal conflict because the individual has the task of giving up one set of gratifications and searching for alternatives that take account simultaneously of biological, psychological, and social challenges. Failure to relinquish gratifications impedes development, while overly rapid learning establishes a gap between instinctual-emotional processes, on the one hand, and cognitive-rational capacities, on the other. This gap leads often to a highly rigid set of conditions for the exercise of competence.*

Whereas I might characterize an egregiously misbehaving entrepreneur as "a **** jerk," Dr. Zaleznik would say it with so much more panache!

Personality and the Need for Power

Whenever I meet an entrepreneur for the first time, I know that there's a 95 percent chance I'll be encountering a Type-A personality. He or she will likely be bright, aggressive, impatient and egocentric. That's the easy part. Which of these entrepreneurs will be successful (and why) is more challenging to assess. Here's where good and bad decision-making comes into play. Manfred F. R. Kets de Vries (Coutu 2004) has devoted his life's work to understanding how capable, visionary and inspiring executives can, nevertheless, make irrational decisions. This has led him into the fields of psychiatry and psychoanalysis to study the complexities of the business leader. Ket de Vries observes: "People in mental hospitals are easy to understand because they suffer from extreme conditions. The mental health of senior executives is much more subtle—[leaders] are insulted to hear that certain things in their minds are unconscious. But like it or not, people have blind spots, and the non-rational personality needs of decision makers can seriously affect the management process."

Another analytical framework involves the laws of the jungle—more specifically, chimpanzees. Dutch primatologist Frans de Waal (Lesly 1995) has studied chimps and views evolutionary psychology as a useful backdrop for explaining the subtle jockeying and constant gamesmanship of the workplace. Chimps demonstrate that the leader cannot allow himself to be too aggressive since his lieutenants will then dedicate themselves to finding a way to topple him. Our innate ape-like aggression may well derive from our inherited gene pool!

The entrepreneurial animal may extend this pattern of behavior. Without the counterbalance of investors—through the board of directors—or trusted advisors, an unbridled bully entrepreneur can desensitize employees, cause organizational neurosis and induce a chain of nonrational decisions. The bully personality takes many forms, as reported by Carey (2004):

- The snake—Jekyll-and-Hyde type who badmouths you behind your back while smiling to your face
- The screamer—a fist-pounder who exhibits public displays of bravado, if not real rage
- The nitpicker—an insulter who employs insinuation to erode the confidence of his underlings
- The gatekeeper—a cold and controlling "god" who plays favorites, permitting some employees to succeed and withholding resources from others

Bias

Decision-making is rarely objective. An entrepreneur's distorted perception of the world often impacts his decision-making reality. Bias can be introduced in a number of ways.

Anti-managerial Bias. Kaplan (1987) writes that once the hero worship surrounding the vogue of entrepreneurship wears off, entrepreneurship may devolve to being viewed as a cliché by critics in large companies and just another opportunity for a hustle. In physics, every action has an equal and opposite reaction. So too it is with entrepreneurs. The chasm between entrepreneurs and professional managers often rivals that of two political parties. The entrepreneur may view the large corporate manager as stodgy and overly protective of his backside. A suggestion to an entrepreneur that a corporate -type might be innovative or enlightened is deemed as oxymoronic as vegetarian meatloaf.

This entrepreneurial bias can preemptively eliminate any opportunity for collaboration with big companies. In two different companies, we have had a founder make a knee-jerk reaction, dismissing out-of-hand the prospect of a strategic alliance with a Fortune 500 company. In each case, it was a terrible decision. A subset of this bias is the anti-MBA bias in the engineering community. Roberts (1992) suggests, "Though their attitude is beginning to change, engineers still regard people in management schools as irrelevant or stereotypically crass."

Metaphorical Bias. We are all guilty of using buzz phrases from other disciplines as a crutch to communicate the virtues of our own little venture. We might reference guerilla marketing (from military science), viral marketing (from epidemiology) or the Internet bubble (from physics). I've demonstrated earlier (with Mulligans), that we can tap into a wealth of sports metaphors. As von Ghyczy (2003) notes, metaphors are a useful complement to business models: "Metaphors can be good or bad, brilliantly or poorly conceived, imaginative or dreary—but they cannot be true." We had one entrepreneur who would not agree to any decision unless it could be explained in battlefield terms. War comparisons, of course, can help in certain aspects of strategy formulation, but fall short in others—say, customer satisfaction!

The Bias of Optimism. When the entrepreneur suppresses pessimistic opinions from his team while rewarding optimistic ones, the venture team's ability to think critically is thereby undermined. Lovallo and Kahneman (2003) comment that while optimism is not a bad trait, it generates more in the way of moral-boosting enthusiasm than decision-related realism. Although optimism enables people to be resilient in confronting difficult challenges, it is less helpful in contributing to difficult, realistic decision-making involving large sums of investor money.

Ethical Bias. Some of my best business friends have acted unethically at one time or another. One entrepreneur was fined millions of dollars by the federal government for performing and invoicing the same contracted R&D [Small Business Innovative Research (SBIR)] work for different federal agencies. Gellerman (1986) addresses how usually honest, intelligent, compassionate colleagues can act in ways that are callous, dishonest and wrongheaded. He cites four rationalizations that have long been used to justify questionable behavior: "(1) believing that the activity is not 'really' illegal or immoral; (2) that it is in the individual's or the corporation's best interest; (3) that it will never be found out; or (4) that because it helps the company the company will condone it."

The old situational ethics issues emerge: How far is too far? What's the line between being smart, and being—as the Brits say—too smart by half? Such ethical bias undermines decision-making and may introduce considerable downside risk.

Decision Methodology

The entrepreneur can encounter decision pitfalls in the very methodology he employs in making decisions. Simple decisions sometimes are not that simple. Decision-making can succeed or fail based on the logic of the decision structure, the initialization values used, the kind of financial variables employed and available information.

Time Sequence. Typically, we think "backwards" in time to diagnose historic patterns and intuit possible chains of causation. We think "forward" in time, using variables in mathematical formulation, to predict or assess future outcomes. Einhorn and Hogarth (1987) argue that forward and backward decision-making are interdependent and can be combined to improve decision-making. A simple example: "How do we get there from here and what are the consequences?" Targeted future scenarios can be rolled back to influence current decision-making.

Anchoring and Adjustment. Entrepreneurs often make forecasts or estimates for decision-making by starting with a favorable, easily available reference value and making adjustments to that value. Often the anchor value is either a result of too much optimism or an oversimplified rule -of-thumb. The ultimate decision can thereby be skewed by the initial anchoring value, and may result in unfortunate outcomes with undue risk.

Framing. A decision is impacted by the way it is structured, or framed. As Teach (2004) suggests, if a frame is poorly presented, an entrepreneur can unwittingly make an "unprofitable" decision. An example might be whether to frame a decision using gross margin (a financial accounting number) or contribution margin (a cost-accounting number). Not acknowledging the distinction between fixed and variable costs can sway the decision—say, whether to accept a contract at a certain price—the wrong way.

Data. Is a little knowledge a dangerous thing? Apparently not always. Sutcliffe and Weber (2003) contend that the accuracy of information is less important in decision-making than the way in which the entrepreneur interprets his competitive environment. If the entrepreneur structures the decision correctly—with the right time sequence, anchoring and framing—then the decision analysis should be okay; if the structure is not correct, perfectly accurate information won't save the day. Again, there are no Mulligans in entrepreneurship!

Parting Shots—Do's and Don'ts

The Don'ts—Where the Snakes in the Grass Lie

The list of decisions not to make is long enough to fill a shelf full of business texts. I choose to identify four major areas of dangerous decision-making.

The Wrong Choice of Business Target. No entrepreneurial activity proceeds exactly according to the business plan. The size of the market can be misjudged, as can the timing of its maturation. The barriers to market entry can be underestimated. Competition can be minimized or ignored completely. In my venturing past, there have been several companies that initially targeted the wrong market. I discussed previously the case of the stubborn CEO who was dismissed for not redirecting the company in a more profitable direction. Two successful examples of flexible decision-making in start-ups come to mind.

- A solar electric company changed its target from power generation to power conversion (uninterruptible power supplies), transforming it from a technological curiosity to a major corporation that now has revenues over $1 billion and over 6,000 employees.
- A color-matching company was redirected from the dental market to the retail paint market, resulting in profitable sales and a successful IPO on the London Stock Exchange.

  Sometimes the decision to reconsider and reassess the business concept represents a series of "small corrections" that can add up to a substantial and positive change. In the case of Il Giornale, an espresso bar, Szulanski and Winter (2002) report that the founder was eventually convinced to stop piping in Italian opera, which customers universally disliked, and to not force the servers to sport uncomfortable bowties, which made them grouchy. Was it worth the decision to change? Upon its renaming, the store morphed into Starbucks!

The Wrong Decision Regarding People. Back in the '70s, I attended a seminar at MIT's Sloan School that featured Admiral Hyman Rickover, "father" of our nuclear navy program. When asked about the biggest obstacle to success, the diminutive military man snapped, "People! The moment you hire your first employee, you have personnel problems!" One need not be a misanthropic nuclear engineer to be wary of the "people issue."

We employ a simple question to bedevil many entrepreneurs: "Why did you hire each member of your staff?" While some of these hot shots provide rationales, others—in the mode of a cranky three-year-old—whine, "Well, because…." Consider how important having a good staff is:

- For years, the mantra in the Boston venture capital community has been that deals are more successful if one has a grade B idea with grade A people than a grade A idea with grade B people. The logic is that the entrepreneurial environment is highly dynamic, and flexibility in strategic decision-making is required (witness the previously cited cases where the company's target market was redirected). This means no relatives or high school buddies are brought on board unless they would have been hired from their resumes, references and interviews. Same thing for the (occasional) "idiot sons" of angel investors; you take in funds for the merits of your venture, not for executive baby-sitting! I've walked from countless deals when I see that the company has a number of clueless hangers-on who are there because of "special circumstances." As the popular phrase goes, the clue train stops regularly and these folks simply don't take delivery!

- When early-stage funds are obtained for a venture, some founders tend to overhire staff, perhaps to off-load some of the workload or, in some cases, to serve as palpable testimony to their success-to-date. While, in principle, labor is a variable cost—the reality is that added payroll becomes an integral part of the monthly "nut" that must be covered by revenues, vendors (accounts payable) or investors (cash). Further, as benefits are added to attract the best and the brightest talent, overhead expenses can escalate. Stires (2004) reports that in the critical area of medical insurance, the average annual premium per individual, paid by employers, is projected to increase from $9,608 in 2003 to $14,565 in 2006. Bad decisions in personnel have costly repercussions.

- The shelf life of the individual entrepreneur must be monitored carefully for on-going viability. There is a concept of "entrepreneurial nostalgia" that might be observed. Many company founders have difficulty coping with the steady-state calmness of a smoothly running operation. They crave that old-time adrenaline surge associated with survival and crisis management. They try to recapture past feelings of being really needed—a big boost to their ego affirmation. On one occasion, I monitored my own shelf life and decided that I was sufficiently bored with the calmness of success in a company that I cofounded. I made a personnel decision: I "fired" myself! On that deal, my entrepreneurial warranty had expired!

Self-Destructive Decisions in Financial Dynamics. I am a devout believer in modeling the financial dynamics of an enterprise on a regular basis. The very act of building the financial model forces the entrepreneur to think through in detail the key elements of the operation in an integrated manner. Many entrepreneurs will agree with me up to this point. They demur, however, when it comes to justifying input data (e.g., purchase orders/letters of intent for sales, bill of materials for cost of goods sold, payroll for labor costs, and so on) and testing the validity of key assumptions. I believe strongly that most critical decisions can be assessed a priori on a "what if" basis. The resistance to this desirable discipline in decision-making evolves from several rationales:

- The information is not available.
- The information is not "knowable" (a Donald Rumsfeld-esque term-of-art).
- "We're not a big company, and I don't have time to waste on these fantasy exercises just to make the board of directors and investors happy!.
- "I don't understand!"

Without such analytical discipline to support entrepreneurial decision-making, important errors can crop up.

- The ramp-up of sales can be overstated.
- The cost of goods sold can be incomplete and therefore understated (gross margins are thereby inflated).
- The build-up in personnel cannot be justified by the levels of revenues and gross profit.
- Expense pools can build up too fast.
- Cash flows are less well assessed, diminishing the accuracy of capital planning.
- Less contingency planning occurs.

Given that there are no Mulligans in entrepreneurial decision-making, studying the venture's financial dynamics with an integrated model is a unique opportunity to make "mistakes" merely on paper, without suffering the cash consequences of real-world decision errors.

Ongoing Errors in Strategic Decision-making. Don't target a market that is too small for your mission, your operational infrastructure or your investors' expectations.

Don't Overly Focus on One Product, Particularly as the Company Becomes Robust and Profitable. The only direction a successful one-product operation takes is towards lower market share, lower prices and eroded margins. An example is Sharper Image. Lee (2004) reports that the company's Ionic Breeze air purifier represents 40 to 50 percent of company revenues, and the cheaper knock-offs from Brookstone and others have slowed Sharper Image's sales and slashed its profits.

Don't Forget to Bootstrap Activities Whenever Possible. Conservation of cash is a golden rule.

- Virtual CFOs and accountants can be hired on a part-time basis to minimize staff expense while assuring proper reporting to investors and banks.
- Outsourcing is now so popular that venture capitalists routinely ask, "What's your India plan?"

Don't Leave the Company Open to Fraud. We don't want people spending the precious resources of the company on themselves! We don't want counterfeiting of company checks or the fraudulent issuance of checks to nonexistent employees or vendors. Wolf and Company (2004) reports that 1.2 million worthless checks enter the banking system each day, and only about 13 percent of check fraud losses are ever recovered. It is recommended that you:

- Use secure check stock (treated inks, safety papers).
- Maintain tight security over the check stock.
- Reconcile bank statements and report any losses immediately.
- Conduct periodic audits.

Don't Forget to Protect Proprietary Assets and Intellectual Capital. Expensive patents are not necessarily the answer—ideas, know-how and processes can and should be secured inexpensively. A corollary of this is to assure that retiring baby boomers are debriefed to retain the critical information they have accumulated over the years. Zarrabian (2004) reports that in 2005 there will be a staggering 39.7 million Americans between 55 and 69 years old. Their skill and knowledge is valuable beyond numbers! Don't decide to let these seasoned pros leave the company without extensive debriefing.

Don't Get the Wrong Investors or Wrong Partners Involved with the Enterprise. I once spent the better part of the first year in one venture unraveling—from my position as board member—a situation where the smallest investor was the crankiest, and the two company principals were incompatible. The company survives, but the dysfunctional staggering-and-reeling that these problems caused out of the starting gate has extracted a significant price.

The Do's—How to Operate Smarter and Make Better Decisions

Keep Your Administrative Housekeeping in Order. This discipline will save you time at critical junctures in decision-making when you want to focus on the merits of the business issue, not on how to find a missing piece of paper. The biggest administrative housekeeping chore, of course, is to implement compliance with Sarbanes-Oxley regulations.

Perform Due Diligence! If there's one area that approximates a Mulligan, it is due diligence. The Chinese fortune cookie reads:"A peek is worth a thousand finesses!" In venturing, an intelligent peek represents both good offense and good defense. As discussed earlier, there are ways to unearth important data on competitors. For potential merger and acquisition deals, due diligence is critical. Rosenberg (1996) reports that fully 10 percent of M&A deals are cancelled because of what is found in due diligence. In an additional 25 percent of the cases, the due diligence findings either cause the deal to be altered or help the acquirer to negotiate a better price. Similarly, due diligence may uncover facts about a prospective executive hire that red lights certain factors. One company found out through investigators that the leading candidate for CEO was more than $100K in arrears in child support payments! The situation was eventually resolved, but the company made a more informed decision with the help of due diligence.

Attract the Right Type of People. The entrepreneur wants to make people decisions that result in a confident, resilient organization:

- Harvard's Kanter (2004) defines confidence as "the sweet spot between arrogance and despair. Arrogance is the failure to see any flaws; despair is the failure to acknowledge any strengths."
- Regarding resilience, Coutu (2002) notes that more than education, experience or training, an individual's level of resilience will determine who succeeds and who fails. This is true in the Olympics, the cancer ward and the boardroom. Resilient people possess three characteristics: a staunch sense of reality, a deep conviction that life is meaningful, and a remarkable capacity to improvise.

Provide Praise. Rath and Clifton (2004) surveyed—through Gallup—more than 4 million employees and found that:

- Negative employees can scare off customers.
- Praise is an important leadership trait, helping to diffuse whining, unappreciated staffers.
- Praise increases productivity, and praised employees generate higher loyalty and satisfaction scores from customers. The results are better safety records and fewer accidents on the job.

Always be Customer-sensitive.

- Revenue is the best way to fund the company.
- Customer-related decision-making is bolstered by data mining, or business intelligence. Example # 1: A retail mart decides to retain slow-moving French cheeses because the informational tracking system tells them that those people who do buy these overpriced cheeses are the mart's best customers. Example # 2: A pub can use software to assess the impact that "happy hour" offers have on daily sales. If discounting a particular drink increases sales one day, that can be repeated. Business intelligence provides the capacity to track inventory accurately and reprice offerings dynamically.

Try to Be Creative. To cite an example: As a board member of a business I cofounded, I became involved in a negotiation with a large company that wanted to invest in our emerging (publicly-traded) company so that we could further our product development. Rather than have them become a shareholder, I convinced all parties that the same ends could be met by having the funds enter our company as contracted R&D revenue—which on our part we could report as sales with modest profits, not as a total R&D expense write-off. The funding company could recoup its investment through product royalties—for them, a much more straightforward exit position than equity. It was a win-win scenario that rewarded creative decision-making.

Parting Shots

Building upon my opening sports metaphor, the opportunity for success involves keeping it close on the back nine (golf) and being within a run or two in the seventh inning (baseball). In the end, success generally occurs when everything is on the line. In the game of entrepreneurship, good decisions, with informed board of directors' oversight, are vital to company success. In this age of corporate governance, I can summarize my observations on entrepreneurial decision-making with 10 questions that a diligent director of the company should ask. Compiled by Charan and Schlosser (2003), these questions underscore how good entrepreneurs can and should be directed to make good decisions.

1. How does the company make money?
2. Are customers paying up?
3. What could really hurt—or kill—the company in the next few years?
4. How are we doing relative to our competitors?
5. If the CEO were hit by a bus tomorrow, who could run this company?
6. How are we going to grow?
7. Are we living within our means?
8. How much does the CEO get paid?

9. How does bad news get to the top?
10. Do I understand the answers to questions 1 through 9? (If not, try again—decision-making is a process. Unlike entrepreneurs, directors can be granted Mulligans. They can ask questions over and over again until the entrepreneur gets it right!)

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About the Author

JOSEPH LEVANGIE is a Boston area investor, adviser and entrepreneur. Over the last quarter century, he has helped launch several dozen new business enterprises from first a large company platform, then from a not-for-profit incubator, and later as an venture adviser, as an independent entrepreneur, as an active investor and as a passive "angel." His companies have competed in a wide array of industries: financial services; renewable energy; uninterruptible power sources; biotech; computer hardware, flex circuits and software; medical lasers; electronic retail color-matching systems; radioactive medical implants; food technology; modular housing; semiconductor equipment; specialty materials; and waste tire recycling. The number of Joe's ventures successfully completing an IPO has now reached double figures. Joe has served on the BODs of dozens of private and public companies, and has been a guest reviewer at Business Plan contests at MIT and Harvard Business School. Joe is an active alumnus of both institutions. He currently is vice chairman of Ardour Capital, a NYC investment banking firm.

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