JOURNAL OF BUSINESS ISSUES

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LEGAL IMPLICATIONS OF BLOGGING FOR ORGANIZATIONS

Ramendra Thakur, University of Louisiana at Lafayette
Anne Keaty, University of Louisiana at Lafayette
Geoffrey Stewart, University of Louisiana at Lafayette

Abstract: Today, more than 11 percent of Fortune 500 companies have corporate blogs as compared to only 4 percent in 2005. That number is expected to increase five times by the end of 2010. Practitioners believe blogging presents significant legal issues which employers must address when managing risk(s). This study presents issues regarding employee blogging and offers managerial guidelines for organizations.

INTRODUCTION

Today, more than 11 percent of Fortune 500 companies have corporate blogs as compared to only 4 percent in 2005. A recent study by the Gartner Group projects that by 2010 approximately 60 percent of the Fortune 1000 companies will use online communities to connect with their customers (retrieved from http://www.dubstudios.com, 2008). Such exponential growth of company blogging should generate interest in the minds of business managers and scholars to better understand this phenomenon. As early as 1990, Stichcombe recognized the necessity of organizational awareness of the injurious as well as the beneficial effects that blogging could have upon a company. Though technology developments have encouraged the growth of new method of communicating with customers (e.g., blog), but studies indicate that not much scholarly work has been done in this area (Etgar 2008; McKenna 2007).

The literature that does address company blogs reveals that the majority of the work done in this area focuses on the motivational and technological aspects of blogging, attempting to answer the "why company blogging is growing" and "how it is growing" (Anderson, Blomkvist, and Holmberg 2007; Gordon 2006; Kaye 2005). While focus on these aspects is indeed necessary, the impact of company blogging on legal liability seems to have been sorely neglected. Mercado and Kierkegaard write in 2006 that there is a range of legal ramifications associated with the emergence of blogging, but a search of business academic databases between the period 2004-2009 indicates that only a handful of studies have been carried out by business scholars dealing with legal ramifications associated with the emergence of blogging. On the other hand, a search of the legal databases reveals that over one hundred law journal articles published just from 2007 to 2009 deal with the direct and vicarious liability companies may experience from corporate blogging. This concern by the legal community indicates that corporate blogging presents significant legal issues that companies should take into account in order to avoid costly liability.

The purpose of this article is threefold in that it will enable managers to answer three strategic questions related to organizational blogging: 1) what are the potential legal liabilities that may result from employee-generated content on blogs; 2) what are the laws that protect a blogging employee that the employer must respect; and 3) what organizational steps could be taken to avoid the legal liability that may result from employee blogging.

LEGAL LIABILITY ISSUES ARISING FROM EMPLOYEE ILLEGAL ACTS WHILE BLOGGING

Vicarious Liability of a Company

In addition to the employee incurring personal liability from illegal acts while blogging, the employer could be vicariously liable for its employee's actions. The law holds that the right of a company to control its employees during the "course and scope" of their employment brings with it responsibility for the employees' negligent, and sometimes even intentional and criminal, actions that cause injury to others. The courts use multiple factors to determine if the employee was acting within the "course and scope" of employment, including where (onsite or offsite, on the company's or employee's personal computer), when (during working hours or not), and why (in promotion of his work for the company or not) the employee was performing the negligent act. For purposes of this article, it will be assumed that the blogging employee was acting within the course and scope of his or her employment. The legal issues mentioned below may arise whether the employee works for an independent company or in-house.

(1) *Disclosure of a Company's or Client's Confidential Information or Trade Secret* (Barr and Naughton 2007; Paul and Chung 2008; Nobile 2007; Solecki and Rosenberg 2005)

Trade secrets, customer lists, production or sales information, or staff organizational information of either or both of the employer or of the employer's client may be compromised, either intentionally or innocently, by an employee blogging about a daily occurrence or meeting at work. An employee may intentionally or unintentionally reveal a company's or client's identity and/or strategic plan by discussing ideas on the blog or posting information regarding how the company solved a problem (Barr and Naughton 2007; McGrath and Fuller 2009). Another issue may involve posting a work-place photo that may inadvertently reveal confidential information in the background.

(2) *Disclosure of Incorrect Information* (Nobile 2007; Barr and Naughton 2007; Paul and Chung 2008)

The Securities and Exchange Commission (SEC) rules and regulations specify that only truthful information may be made public by an issuing company concerning a newly issuing security during the SEC registration process as well as when a company is experiencing a market-affecting change. While these rules apply to the issuing company, a company might be considered an agent for the issuing company when implementing its marketing strategy. If information about a company's new product or plans to merge or buy another company is revealed in an untimely manner and/or inaccurately by the company's employee on his/her blog, it could result in SEC vicarious civil or criminal liability for the company, and, by agency law, for the client.

(3) *Defamation or Disparagement* (Grubman 2008; Nobile 2007; Barr and Naughton 2007; Paul and Chung 2008)

A company's employee may defame a competitor or the competitor's product while blogging, perhaps out of loyalty to his or her own company. If the employee publicizes an untrue fact about a competitor or its product, a customer, a supplier or other member(s) of the supply chain, the employee would be liable for damage suffered by the defamation and the employer vicariously liable.

(4) *Copyright and Trade Mark Infringement* (Nobile 2007; Barr and Naughton 2007; Paul and Chung 2008)

While the marketing communication specialists and senior executives within a company are familiar with intellectual property laws, blogging employees may not be so aware. The blogger may post pictures and slogans, or use another's trademark in the metadata of the employee's website in order to elicit more "hits" from search engines, all of which can be trademark infringement. An employee who is held liable for copyright or trademark infringement may impose vicarious liability on his or her employer.

(5) *Violation of Consumer Protection Laws*

In an effort to promote his or her own company or client, or make a sale, the employee may post false product advertising or false information about the company's credit agreements with its consumers in violation of the Federal Trade Commission rules and regulations and the employer vicariously liable.

(6) *Threats of violence, discrimination, and invasions of privacy* (Paul and Chung 2008)

Threats of violence against fellow employees or the company can result in employer liability if not taken seriously, investigated, and mitigated. Employee blogs that contain discriminatory or sexually harassing comments about fellow employees result in vicarious liability, as can inappropriate facts posted that rise to the level of invasion of privacy.

Employee Protections While Blogging

When pursuing the investigation and correction of employee unlawful acts while blogging; the following rights of the employee should be taken into consideration.

- Employees who work for private employers are not expressly protected by the First Amendment (Nobile 2007; Barr and Naughton 2007; Paul and Chung 2008; Solecki and Rosenberg 2005; Zebrowski, et al. 2008), but in some states, employees may be protected by state constitutions or statutes, or the courts may find that it is against public policy for an employee to be prohibited from stating his political views.

- Some states have "off-duty" statutes that prohibit the employer for taking action against an employee for activities engaged in while the employee is off-duty, such as posting inappropriate comments or pictures (Barr and Naughton 2007; Solecki and Rosenberg 2005).

- The National Labor Relations Act (NLRA) contains provisions that prohibit the employer from interfering with employee discussion of labor issues, such as hours and wages (Zebrowski, et al. 2008).

- The Civil Rights Act of 1964 prohibits employer retaliation for employee complaints, as do other laws containing whistleblower provisions, such as the Sarbanes Oxley Act (Barr and Naughton 2007; Solecki and Rosenberg 2005; Grubman 2008).

- Courts have found it may be a violation of the Electronic Wiretap Act for an employer to use an employee's password to get onto an employee password-protected blog.

- The employee under contract may have an action against the employer for breach of contract, unless the terms of the contract set out reasons related to blogging for which an employee may be disciplined or terminated (Grubman 2008; Solecki and Rosenberg 2005; Zebrowski, et al. 2008). Even in "at will" employment situations, if there is a collective bargaining agreement in place, which demands "just cause," for termination, the employer may not fire without "just cause." If the employer has set out a policy concerning blogging and the employee violates that policy, this can be just cause.

Policy Guidelines for Marketing Managers

With blogging becoming an important way for companies to connect with their employees and customers (Cornwell 2008), it is crucial for senior marketing executives to understand the range of legal ramifications associated with the emergence of this phenomenon. A study conducted by Harris Interactive indicated that 47% of senior executives say that their organization do not have corporate policies pertaining to blogging, despite the fact that 77% believe that they should. Therefore, to avoid legal liability, it is suggested that the senior marketing executive should focus on the following.

- Decide whether there will be an official company blog and if it will be open to the public.

- Decide if they want employees to work on the company blog or have a link to it to their own blogs.

- If employees link to the company blog, have them make a disclaimer that they do not speak for the company and that all opinions expressed are their own.

- Decide whether the company should have a Blogging Policy and continuously publicize the policy to inform new employees.

- Decide whether to set up an in-house employee committee to monitor employee blogs.

- Appoint a person (e.g., chief blogging officer) to whom employees should go if they have questions about blogging or concerns about the conduct of other employees on their blogs (Bulik 2008). If there is more than one point person, employees may be confused as to whom they should report and may not report at all.

- Train to avoid and remind employees of the particular legal liabilities mentioned in this article.

- State which company trademarks, logos, music, and photos may be used by employees on their blogs and how they may be used.

- In the Company Policy state as appropriate for your company:
    - that the company is not in favor of anonymous blogging and employees are liable for their blogging activities;
    - whether employees may blog during working hours and/or on company computers and whether their blogging activities will be monitored;
    - what employees are to do when confronted with press and consumer inquiries;
    - that penalties or termination may be a consequence of inappropriate blogging;
    - that they are expected to conform to offline company behavioral policies online as they do offline.

CONCLUSION

With blogging becoming an important way for companies to connect with their employees and customers, it is crucial for practitioners to understand the range of legal ramifications associated with the emergence of this phenomenon. This paper suggests that blogging activity can be nurtured and managed. It provides useful insights related to the potential damage and liability that may result from employee-generated content on blogs and the legal protections for the employee's blogging that the employer must respect.

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THE BUILDING AND EROSION OF A SMALL BUSINESS IN THE INNER CITY: LESSONS IN ENTREPRENEURSHIP

Theodore E. Davis, Jr., State University of New York College at Buffalo

Abstract: With the help of competitive intelligence, diversification, and an integrated package of policies for systematically building the intangible asset of corporate reputation, a small business went from making $100 per day in sales to $4,000 per day in sales. Systematic planning and implementation enabled this small business to improve its competitive position by gathering information, analyzing it and offering strategies to define its market, and to leverage its core competencies. However, the owner/manager personal values were not congruent with these strategies and the turnaround of the business was rapidly undermined as these values were implemented again.

INTRODUCTION

Background

At any given time, between 20 and 30 percent of all companies are in need of a turnaround (Murphy, 1986). The rapid pace of change in today's markets has caused competition to become so strong that products have become outdated at an extraordinary rate. And in some industries, "simply doing your best does not cut it anymore because your best can be mimicked too quickly and easily," says Faye Brill, president of the Society of Competitive Intelligence Professionals in Alexandria, Virginia (*Entrepreneur*, 1996). "A company's competitive advantage can be eroded more quickly now than ever before" (*ibid*.).

This need often is felt most in the small business sector, since small firms are especially susceptible. They lack the product diversity to cushion the loss of key products, and they have limited resources for developing new ones. They often operate within small, unstable market niches that can get smaller or that can be invaded by low-cost competitors. Without the cash or market power needed to defend against competitors, their markets are easy prey for larger companies.

The management process in the small firm is unique. Strategies such as divesting a strategic business unit, diversifying into a more stable business, or easing operating distress with a short-run financing from a parent company are not generally available to the small firm. It bears little or no similarity to management processes found in larger organizations, which have been the subject of considerable academic research resulting in numerous models, prescriptions, and constructs (Jennings and Beaver, 1995).

Statement of the Problem

The primary purpose of this exploratory study was to identify areas of distinctive competence in an inner-city small business. A secondary purpose was to assess the extent to which these competencies can lead to competitive advantage and sustainable competitive advantage. The case study was an inner city, African American, family-owned tavern located in a medium size city in a Midwestern state. I became general manager on October 1, 2007, for three months, at the request of the owners in order to turn the business around, improve performance, and establish a competitive advantage. However, the longer-term outcome, in

terms of success or failure of this small firm, was strongly influenced by the personalities, values, and abilities of the owners.

Examining the success of this African-American, family-owned tavern is significant because the role of the entrepreneur does act as an engine for economic development in the black community. In addition, this tavern has always played an important role in the success of black business owners for networking and as a builder for the black community in terms of social, economic, and political engagement. Without this tavern, there would be an opportunity structure that would hinder black business ownership, because the infrastructure, within the black community would have been destroyed especially the black entrepreneurs ability to gain access to markets.

Research Questions

In the initial interviews at the family-owned and operated tavern, several problems were identified including severe negative cash flow, a belief that not all sales to customers were being billed or collected, and a paper-heavy system that was cumbersome. This research explores three areas that relate to the problems concerning this inner-city tavern. They are:

1. What are the strengths and opportunities where this inner-city tavern's core competencies could provide a competitive edge?

2. How does this inner-city tavern's core competencies relate to its culture and context?

3. What are the new markets in which this inner-city tavern's core competencies could create customer value?

Core competencies are those skills required for this company to compete successfully in its market niche. Those skills include team building, quality management, and problem solving. Culture consists of the values and traditions that are vital to the business. Context is related to an understanding of the tavern's strategic goals and objectives as they relate to the market niche.

A major obstacle in turning around or reengineering a small business is the staff that has worked at the business for years tends to acquire an ownership in the current process and, as a result, may be unable or unwilling to consider a radical change in the process. Contrary to conventional wisdom, a majority of businesses fail because of internal factors that are affected by managerial action and discipline (Boyle and Desai, 1991). Examples include failure to control operational costs and analyze financial statements.

Researchers, such as Foley and Green (1989) who have studied small business failure and success, have attempted to classify underlying reasons. However, the majority of studies simply identifies symptoms and fails to highlight causes when providing explanations within the context of "rational management theory." Equally, many surviving small businesses are seen, in terms of rational theory, to operate at sub-optimal levels of performance. The actual root cause of failure may lie with the apparently non-rational behavior and decision-making of the entrepreneur and/or owner-manager. He/she does not obey the "rules" of classical management theory (Jennings and Beaver, 1997). The small business practitioner is, therefore, subject to a number of competing and contradictory influences, which may lead to erratic, unpredictable, and self-destructive behavior.

Small business managers can endeavor to strengthen their market status by establishing a positive reputation in the shortest time possible (Goldberg et al., 2003). This reputation defines a company's identity – as seen by important stakeholders – in the market competitiveness of its products and/or services, the effective management of its resources, and its potential for future success (*ibid.*). As an intangible resource, such a corporate reputation could prove pivotal in obtaining legitimization within the marketplace (Fichman and Levinthal, 1991). Others perceive a good reputation as an indicator of a firm's overall effectiveness attracting investors, decreasing costs as suppliers offer better terms, encouraging customers to purchase the company's products or services, and assisting in the recruitment of skilled labor (Dollinger et al., 1997; Fombrun, 1996). Despite its attractiveness, few small business managers make a sensible and deliberate decision to use a reputation-building strategy. Indeed, managers will find few references to such a strategy in the small business literature (Goldberg et al., 2003).

ISSUES

From the theoretical framework discussed above, several questions were developed for this research.

1. What are the costs to build a competitive advantage?

2. What are the business' distinctive competencies that can lead to a competitive advantage that can be sustained?

3. To what extent does relying on the existing core competencies generate a competitive advantage in new markets?

4. What constitutes success?

METHODOLOGY

Design

Because this study uses participant observation and in-depth interviewing, a qualitative research design using a naturalistic or field study serves as the framework for this study. This descriptive research involves data collection on many variables over an extended period in a naturalistic setting. In the instant study, the period is seven months.

Subjects and Procedure

This inner city, African American, small business tavern was experiencing declining performance. This small business required several actions, which were: (1) specific acknowledgment of causes, (2) timely performance, and (3) sufficient assets to have some bearing on a turnaround, and (4) identifying this small tavern's management practices. The first step was an external investigation to discover minor, but potentially crippling, changes in the competitive environment. The second step was to notify the owner that it was important not to assign the lackluster performance to sheer "bad luck" or uncontrollable market forces. Because of new technologies, substitute materials, changing consumer tastes, and shifting consumption patterns are shortening product life cycles, this inner-city tavern was required to develop a steady stream of new services. As outline by Porter (1995), this inner-city tavern already had a potential competitive advantage in five areas to work with, which were:

1. Strategic Location – possible advantage because it could gain from its closeness to the downtown business district, the logistical infrastructure of a main highway and bus transportation, its closeness to the entertainment and tourist destinations, and its closeness to the concentrations of both major and minor companies.

2. Local Market Demand – even though average wages are low in the inner cities, high population density creates considerable purchasing power and a large market. Inner-city markets are not only large but also young and quickly growing. By focusing on satisfying ethnic needs does not automatically limit the growth and potential of this inner-city tavern, but instead, a focused strategy could provide a competitive advantage over large established companies and a base from which to expand into other market segments (e.g. Bennigan's, TGIF, Thursday, etc.). An even more exciting opportunity presented itself when it was realized that the needs and tastes of inner-city consumers represented trends that often cross ethnic and socioeconomic strata.

   People in largely lower-income ethnic and minority communities have distinctive needs and tastes, which demand customized products and services. However, most companies design products and services for white middle-class consumers and businesses, hence, their product configurations, retail concepts, entertainment, and personal and business services do not fit inner-city customer's needs. This means that there was an unmet demand of the inner city's population, which created a major growth market; whereby, the principal inner-city business opportunity sprang, however, not from the size of the market but from its character. Micro segmentation lags in the inner city, but it represents a great opportunity. This inner-city tavern is uniquely positioned to understand and address the needs of its consumers and the businesses in its own and other similar markets.

3. Integration with Regional Clusters – while this inner-city tavern was currently isolated from the regional economy, those unique regional clusters represented promising opportunities for financial growth.

4. Human Resources – the workers at this inner-city tavern are from the inner city, which are often more motivated and loyal, especially since this is a business that suffers from high turnover.

5. Access to capital – According to Porter (1995) this is usually a disadvantage for inner city small businesses. However, this inner-city tavern has access to personal and family savings and networks of individuals to draw on for capital.

According to Porter (1995), the disadvantages of this inner-city tavern because it is located in the inner city include:

1. Non-wage costs – high costs for utilities, workers' compensation, health care, property insurance, unemployment and liability insurance, real estate and other taxes, Occupational Safety and Health Act compliance. Because this medium size Midwestern city has a greater proportion of residents dependent on welfare, Medicaid, and other social programs than their suburbs do, this city must spend more and thus charge higher taxes.

2. Security – crime is a real obstacle to doing business in the inner city, but the perception of crime is greater than reality.

3. Employee skills – even though this inner-city tavern is a bar, the workforce lacks the skills to work in the bar, which needs more than just the basic skills. In addition, while there is a large pool of available lower-wage labor, most of the residents do not have the skills suitable for this bar.

4. Management skills – the owner and the former manager lacked formal managerial training, especially in the areas of strategy development, market segmentation, information technology, process design, and cost control.

5. Attitude – while this is a locally, minority-owned business, which hires locally, the hard truth is that its attitude constitutes a significant barrier to its current and future economic development. This inner-city tavern has a reputation of worker exploitation, being in business primarily to earn profits for its owners, due to it having a captive market by being the only legitimate black-owned and oldest bar in this Midwestern city; as well as complacency. This attitude undercuts efforts to improve quality of not trying to sell beyond the captive market, and reducing costs. It believes that it can give any type of service because it serves "Coloreds."

I took over managing the tavern on October 1, 2007, which earned about $100 per day in sales; had very little supply and variety of liquor, as well as the tavern and equipment was in disrepair from the lack of maintenance. The owner and former manager used the profits for their own use while the employees stole money from the establishment. From July 1 until I took over, I went to the competitors to see what they were offering as far as service and products. I patronized them, and kept an eagle eye out for areas in which I could surpass them, especially in service, i.e., more frequent follow-up and faster delivery.

I administered a customer questionnaire to turn up many areas upon which I could concentrate including: why they patronized the businesses they do; what the ideal business would offer; and what they like best about this inner-city tavern. I paid close attention to the answers because some were pointing directly at possible changes to improve the competitive advantage.

In addition, I instituted a training program to give the employees an understanding of the tavern's role in the marketplace and to allow the workers to learn more quickly and be more productive. This training program provided instruction in what are known as the "three C's": culture, context, and core competencies. The focus of the training was how employees can improve the quality of service and explain the benefits and features of those services to current or potential customers.

The competitive strategy used by the tavern was the multidimensional concept as outlined by Porter (1980), which consisted of the five common dimensions of business strategy:

1. Innovation differentiation (aims to create products to services that customers see as unique in terms of technical performance, design, and/or quality),
2. Marketing differentiation (attempts to create a customer loyalty through advertising, prestige pricing, and/or market segmentation),

3. Cost efficiency (a strategy that strives to deliver products or services to customers more cheaply than competitors do by lowering costs per unit of output),

4. Asset parsimony (strategy of low cost through few assets per unit of output), and

5. Domain scope (or niche strategy, determine the type of customers, products or geographic coverage the firm concentrates on) (Hambrick, 1983; Miller, 1986, 1988).

This inner-city tavern used the strategies of innovation differentiation, marketing differentiation, and domain scope. It was determined that the tavern could not apply the alternative strategies of cost efficiency and asset parsimony.

The factors external to the tavern, requiring aggressive market responses included diversification, niching, market development, product development, and market penetration. Market penetration included diversifying into a countercyclical industry and finding a niche in a market up, to now unexplored by the competition – especially one this tavern was uniquely qualified to occupy and defend.

In addition, I instilled several characteristics as "best practice" that was outlined by Sandvig and Coakley (1998) within this inner-city tavern. They are:

1. Leveraging existing capabilities – Significantly lowered the costs and risks of diversification by using the existing core competencies to gain entry into new markets. I formed partnerships with the police and local businesses to serve meals at discounted prices in order to receive services. In addition, became a member of the local chamber of commerce, as well as the local black chamber of commerce.

2. Entering growth markets – Diversified into rapidly growing markets, such as Illinois lottery and Games for "Entertainment Purposes Only" (penny and nickel slot machines). Entering these markets avoided expensive battles for market share against well-entrenched competitors. Chandler and Hanks (1994) found a positive relationship between market attractiveness and new product success.

3. Targeting niche markets – Targeted small niche markets, where customers are willing to pay premiums for products tailored to their needs (i.e. this inner-city tavern was the only place in this medium size Midwestern city that served Kosher Hot Dogs, as well as Rib-eye Steak Sandwiches and chili. It also had one of the biggest selections of alcohol – 100 different selections; bottled beer and wine coolers – 33 different selections; as well as serving coffee, soda, and bottled water. The jukebox was the only place in this medium size Midwestern city that played and advertised only blues, jazz, R & B, reggae, and hip/hop – the box contained 200 c.d.'s selections, as well as a black only music downloading selection). Niche markets are typically less competitive than larger markets.

4. Diversification strategy – Targeting new markets and adding new capabilities that require thought and the development of an effective diversification strategy (e.g., added an ATM). The successes realized by the Japanese through operational efficiencies during the 1980s maintains Porter (1996), have lured many companies into focusing on efficiency at the expense of looking forward to develop new products and markets.

5. Adding new capabilities – To enter target markets, this inner-city tavern added new capabilities, such as updated technologies and marketing skills. In addition, strong top management leadership, by having an aggressive manager to lead the diversification efforts, have taken decisive – and sometimes risky – measures to reposition the tavern. These actions included major investments in new products, downsizing, and developing new competencies and market channels. For example, added a Women's Night with an amateur male strippers contest; a free drink and cake for a patron with a birthday; had two digital televisions featuring sports; collaborated with other clubs and local black chefs for more of a variety of food and entertainment; and sponsored poker and other card games.

6. Skilled work force – The skill and flexibility of the work force was an important asset. This inner-city tavern grew because of the remodeling and the workforce. People saw us trying entrepreneurial things and changing the way we were doing business. We required that people be self-motivated and self-starters. They must understand their customers and their customers' needs without a manager overseeing them, which included learning the latest mixed drinks.

7. High employee productivity – This inner-city tavern avoided adding to its work force as the amount of services being offered grew, even reduced the workforce; however, gave them a raise in salary from $120 to $192 plus tips per twenty hours of work. Thereby, productivity increased, lowered overhead costs, and gave employees more autonomy; however, security cameras in the tavern and listing devices in bathrooms were added.

8. Low overhead – Maintained a lean management structure and employed few overhead personnel, as well as changed all vendors, including garbage, and negotiated with distributors.

9. Tenacity – Had little choice but to diversify, shrink, or go out of business. Unlike large companies that can still prosper even after closing entire divisions; the fate of small firms often rests on the success of their diversification efforts. When a small firm fails, all of its employees lose their jobs, including top management.

Results

Does it cost much to offer a competitive advantage? It takes aptitude, time, vigor, and imagination; it is not a matter of money. The financial possibilities of the inner city can be realized when companies leverage the competitive advantages and when the disadvantages are confronted directly. Most of the disadvantages of locating businesses in the inner city can be disposed of, controlled, or conquered.

The owner wanted to close the tavern, but my recommendation was against this. I wrote down everything that needed to be done to make the tavern profitable again. There were 30 items on the list, some of these things were hard to do – but they provided an alternative to closing the tavern. Top of the list was to make temporary staff cuts, increase prices by 20%. Our backs were to the wall. We immediately got much tougher and everyone just had to tolerate it – although we lost some customers along the way. These actions worked extremely well and within three months, the tavern was back making a profit, from making $100 per day in sales to over $4,000 per day in sales.

The turnaround of this small tavern provided an example of effective niching. This tavern was experiencing a decline of its customers; and it was unable to replenish its customer base, because it catered to an over 60 years of age crowd. Through market research, the tavern identified a suitable customer segment (of an over 30 years of age crowd) and developed an advertising program targeted toward this specific niche, by putting flyers in beauty and barber shops, as well as partnering with businesses next door. Since redefining and pursuing its newly identified target market, the tavern got back its customers and expanded its customer base.

In addition, it was accepted that a good corporate reputation was important for receiving legitimization from different stakeholders. By combining the strategic elements of having a company policy of strengthening internal core competencies, extending external relationships, and creating a positive corporate image, I used several distinctive competencies to establish a strong reputation for this inner-city tavern. A distinctive competence is of value in a competitive environment only if it can be transferred into a competitive advantage. The establishment of a strong reputation, as well as obtaining a sustainable competitive advantage was concentrated in four distinctive competencies that were outlined by Stoner (1987):

1. Experience/Knowledge – In order for the “experience/knowledge" skill of owners/workers to point to a competitive advantage, this competence must be present as a significant buying condition for possible customers. In other words, this competence is important to the buying public only if the “experience” is somehow indicated in the assistance. If this is the case, customers must be conscious that the experienced workforce has led to a better service. I made customers aware of the distinctive competence by having considerable advertising through flyers, posted in barbershops, beauty salons, social clubs, and various workplaces. However, once the customers understood and accepted this competitive advantage, its sustainability was likely to be strong. In general, rival businesses would have to consume substantial amount of assets to erode or change customers’ opinions once the competitive advantage was established.

2. Unique/Special/Original Product and Service – The distinctive competence of having a “unique/special/original product and service” suggested the obvious potential for being a significant buying condition, and the competence was simple to communicate especially if the product and/or service truly fulfilled customers’ wishes. The products and services at this inner-city tavern truly fulfilled customers’ wishes. We were the only bar/tavern that had the Illinois lottery in place, as well as the only bar/tavern that had an ATM. In addition, this tavern was the only inner city bar that served food until 2:00 a.m. Thus, this distinctive competence gave the impression that it could easily lead to a competitive advantage, whereby, sustainability depended upon competitors’ capabilities to offer similar or alternative products or services as dictated by consumer demand.

3. Better more complete customer service and relative quality of product/service – “Better more complete customer service and relative quality of product/service” was likely to be an important buying condition as long as price was not adversely affected. Prices increased by 20%, however, more services were being offered, as well as more variety of drinks. In addition, this inner-city tavern was being promoted as a local, friendly community bar, where everyone was welcomed. It was no longer a bar for the owner’s personal use. These areas of distinctive competence were

quite difficult to establish and project to potential customers, but once it was established, they were likely to remain strong and sustainable.

4. Location – "Location" was difficult to measure. This inner-city tavern is located just two blocks south of the downtown area on the main highway. The influence of this competence as an important buying condition is significant, since having a bar at this location is central do to the service being offered. Communicability is direct and straightforward. Sustainability due to the fixed nature of location is strong (particularly since this desirable location is not readily available to the rival businesses).

Finally, the biggest lesson that I learnt is that it pays to be firm with staff and customers alike. It went totally against my character, but if I wanted to excel, I had to do it. Otherwise, I would have been ineffective. In addition, I kept a close eye on accounts from day one. I had to set up monthly accounts so one would know from month to month how one was doing. I then made sure that I had trustworthy workers. Having the right team behind you was very important for success.

Although the turnaround was successful, the owner wanted to pursue other strategies. For instance, the owner wanted the tavern to attempt to move from a focus differentiation to a low-cost strategy. It was argued that the distinctive competence of "low cost/price" is certainly a key buying criterion, and price can be communicated easily. Thus, this distinctive competence can clearly be transformed into a competitive advantage. However, sustainability depends largely on the ability of rivals to undercut prices or to offer substitute products or services at a lower cost, which was very real with all the illegal clubs that served alcohol at discounted prices. No way could this inner-city tavern compete with them. In addition, this tavern possessed few of the capabilities needed to achieve the competitive advantage of a low-cost strategy in its new markets. Both the costs and risks involved in making such a change would have increased. In contrast, when this inner-city tavern sought to diversify into new products and markets, it improved its chances of success by pursuing opportunities that required no change in its fundamental competitive strategy.

With the changes in management, after I left, profits were not sustainable (or transferable) with the lack of some type of competitive advantage. After the 3 months, the owner took control of the bar, and retained the same workers as before my take-over. In addition, she hired her own nieces, who had no formal management training, as management. The bar went back to its former state. Most of the new customers discontinued patronizing the bar, and only the owner's acquaintances (who were over 60 years of age) stayed. Instead of putting money back into the business, the owner and her nieces used the money for their own use, and the bartenders went back to stealing. The variety and supply of liquor vanished. All lottery machines, gaming machines, ATM, jukebox, and security were pulled, as well as the sports programming. She had no more Women's Night, as well the birthday cakes and free drinks. The bartenders refused to make any more sandwiches and mixed drinks. The music was mostly old blues that no one wanted to hear except for the owner. The bar again became a place for the owner's personal entertainment use. Therefore, sales plummeted to the original level before October 1, 2007; however, the owner viewed this inner-city tavern as a success because now her aspirations were satisfied. She viewed this inner-city tavern as a "Colored" bar, which should only serve "Coloreds." She did not need "Whites" to frequent the bar. In addition, she believed that "Coloreds did not deserve good service or to be treated with respect….Coloreds should be grateful to have a tavern to go to….this bar was doing them a favor by being open."

DISCUSSION

In a small business enterprise, the decision-making process is characterized by the extremely personalized preferences, biases, and opinions of the firm's entrepreneur, owner, and/or owner-manager. The disposition of managerial activity expands or contracts with the characteristics of the person fulfilling the role(s). Such expansion or contraction is partially trained by the adaptive wants of the environment in which the business functions, and is partly dependent upon the personality and needs of the owner, manager, or entrepreneur. The obsession with immediacy and short-termism is probably as precise a generalization about the managerial participation to small business failure as we are likely to get. Put another way, small business failure is invariably caused through a lack of responsive managerial strategic attention, which is confirmed in this study.

The basis of the failure to attain and sustain an acceptable level of performance is primarily due to poor managerial aptitude. For example, the owner wanted to use a low-cost strategy, even though the tavern's competencies lie in a focus-differentiation strategy. However, the direct attribution of cause and effect relationships is additionally complicated by the intangible, invisible, almost unconscious procedure of practicing strategic management, which exists in the majority of small businesses.

Another characteristic, of the small firm management process, is the closeness of the important players to the operating employees and activities being tackled. This provides the important players with extraordinary opportunity to influence these employees and activities directly. However, relationships are often informal, with no precise definition of rights and obligations, duties and responsibilities. Appointments and promotions are often made based on birth or personal friendship rather than based on ability, education, and/or technical qualifications. Organization structures, as far as they exist, are likely to develop around the interests and abilities of the key players. Such organization structures are likely to be organic and loosely structured rather than mechanistic highly bureaucrat. Thus, the exploitation of competitive advantage in the small firm is hardly ever a readily visible practice. It often has a theoretical rather than explicit form with strategic management being practiced instinctively.

Entrepreneurs and managers, because they alone have profit-oriented reasons and incentives, should seek out the best opportunities for generating wealth. The business community, however, must rethink its strategy and employ new perspectives to do extremely well in the inner city. The private sector will contribute more when it focuses on what it does best: generating wealth and building competitive businesses. As Porter (1995) indicated, four goals should guide private-sector strategies:

1. Create and expand business activity in the inner city. The most significant contribution a company can make in the inner city is simply to do business there. Inner cities hold untapped possibilities for building profitable businesses if companies look for and take hold of the opportunities that build on these advantages.

2. Adapt operating practices to meet inner-city needs. Successful inner-city businesses have learned to adapt their products, services, and operating practices to the local market. One way companies increase their knowledge of the inner-city market is to build relationships in the community and hire locally. Neighborhood employees build loyalty from neighborhood customers and help stores customize their offerings.

3. Deal with disadvantages creatively.

4. Establish business relationships with inner-city companies. By entering into joint ventures or customer-supplier relationships, outside companies can help inner-city companies by encouraging them to export and forcing them to be competitive. In the end, both sides benefit.

Summing up, small businesses can increase their odds for success by designing systematic strategies toward the establishment of a positive corporate reputation. As explained in this case study, I chose to develop the inner-city tavern's internal capabilities, moved quickly to make the most of a market, and tried to establish strategic alliances. In addition, I invested in image factors that signal quality products and a successful enterprise. Beyond a single reputation-building strategy, I recognized the benefits from a comprehensive approach that completely included all four methods for building positive corporate reputations. What was essential was knowledge of the system that exists and a willingness to consider radical new processes that would dramatically add to the system.

However, it seemed that the owner had a different meaning of success, which was "the continued fulfillment of main stakeholder's desires." Logically, the definition of failure would be "the inability to fulfill main stakeholder's desires."

It was immediately obvious that success was no longer looked upon as synonymous with optimal performance since this represents an extremely elusive concept. Similarly, failure no longer was looked upon in terms of the traditional, rigid paradigm of the end of trading. Rather, success was considered as the achievement of certain pre-defined objectives which satisfied the stakeholder's desires and which culminated in performance that fell significantly below the possible optimal level (Foley and Green, 1989). Equally, failure implied that the stakeholder's desires were not, and were unlikely; satisfied even though the business may have been very able of continuing to do business, although at a sub-optimal level and may have even profited from a period of growth and business development. The owner and former manager had kept the profits of the bar for their own use instead of using it for the maintenance of the bar. The bartenders stole money, as well as liquor. However, at this moment, the owner viewed the bar as a success even though it did not make any substantial money. What she wanted was a place that was an extension of her living room, yet profitable. She was not looking for a place to maximize profits.

Because of her viewpoint of success, the black community in this town is in jeopardy. This tavern is no longer the infrastructure necessary for community development, supplying the economic and social benefits that are needed. The networking that took place in this tavern provided employment opportunities for African-Americans and created an avenue for blacks to be integrated with the majority community and economy, thereby, minimizing the feeling of disenfranchisement.

Further study of this tavern is needed in order to determine the economic impact that this tavern has on the black community, as well as the economic development to this area. Therefore, what is the measure of this tavern being the nexus in building an entrepreneurial community, and can an entrepreneurial community be built in this community without this tavern?

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THE IMPACT OF NEW FAIR VALUE GUIDANCE ON FINANCIAL REPORTING: EVIDENCE FROM THE BANKING INDUSTRY

Randall Zhaohui Xu, University of Houston-Clear Lake
Hui Du, University of Houston-Clear Lake

Abstract: In April 2009, the FASB issued a series of fair value guidance (FAS 157-4, FAS 115-2 and FAS 124-2, and FAS 107-1 and APB 28-1). The guidance is effective for fiscal periods ending after June 15, 2009, with early adoption permitted in the first quarter of 2009. Some banks' early adoption of the guidance provides us an opportunity to make a timely study of the impact of the standards on financial reporting. We hand-collected data from banks' 10-Q filings. In our sample of 398 banks, 47 banks early adopted the guidance. Banks' disclosure demonstrates that the guidance had substantial favorable effects on the early adoption banks' asset valuation, earnings, and core capital. Regression analysis indicates that the early adoption banks have more assets carried at fair value than non-early adoption banks and that the early adoption banks were motivated to boost core capital ratios and to avoid reporting losses. Our findings provide timely information for standard setters and regulators to evaluate the effects of the guidance on fair value accounting. This study also presents detailed statistics that can be applied by accounting educators in the classroom to inform students and be used by accounting researchers to inspire future research.

INTRODUCTION

Amid the outcry from the financial institutions to amend fair value accounting standards in the last financial crisis, the Financial Accounting and Standards Board (FASB) issued a series of guidance on fair value accounting in April 2009 (i.e. FSP (FASB Staff Position) FAS (Financial Accounting Standards) 157-4, FSP FAS 115-2 and FAS 124-2, and FSP FAS 107-1 and APB 28-1).[1] All three FSPs are effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The early adoption of the fair value guidance by some financial institutions offers an opportunity for us to make a timely examination of the impact of the new accounting standards on financial reporting.

FSP FAS 157-4 potentially affects the valuation of assets and liabilities carried at fair value. FSP FAS 115-2 and FAS 124-2 affects both earnings and core capital with the amended requirements on impairment loss classification. The banks that early adopted the standards generally disclosed information about the effects of FSP FAS 157-4 and/or FSP FAS 115-2 and

[1] FSP FAS 157-4 provides guidance on estimating fair value when the volume and level of activity for the asset and liability have significantly decreased in relation to normal market activity and identifying a transaction that is not orderly. FSP FAS 115-2 and FAS 124-2 amended the other-than-temporary impairment (OTTI) guidance for debt securities to improve the presentation and disclosure of OTTI on debt and equity securities in the financial statements. FSP FAS 107-1 and APB 28-1 requires a publicly traded company to include disclosures about the fair value of its financial instruments whenever it issues summarized financial information for interim reporting periods. The FSPs are available at: http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1175801890297.

FAS 124-2 in their 2009 first quarter 10-Q filings. This paper focuses on examining the impact of the two FSPs on banks' earnings and core capital and explores the factors and incentives that affected banks' early adoption decisions.[2]

We hand-collected data related to the early adoption of the new fair value guidance from 10-Q filings of all banking and depository institutions (SIC 6000-6099) for the quarter ending on March 31, 2009. Out of our final sample of 398 banks, 47 banks early adopted the FSPs in the first quarter of 2009. Among the 47 early adopters, 38 banks acknowledged in their 10-Qs that the application of FSP FAS 157-4 and/or FSP FAS 115-2 and FAS 124-2 had significant impacts on their financial statements, a ratio of 81%, whereas only three of the 351 non-early adoption banks expected the new guidance to have significant effect on their financial statements.

Five banks provided details about the effects of FSP FAS 157-4 on their financial reports. Their disclosures suggest that the adoption of FSP FAS 157-4 lead to higher valuation of assets carried at fair value. The FSP mainly affected the valuation of available-for-sale and hold-to-maturity securities rather than trading securities. Consequently, the higher assets valuation from the application of FSP FAS 157-4 generally resulted in increased unrealized gains/reduced unrealized losses that are charged to the accumulated other comprehensive income account (AOCI). For example, Wells Fargo disclosed that the adoption of FAS 157-4 resulted in an increase in the valuation of available-for-sale securities by $4.5 billion, which is included in AOCI, and an increase in the valuation of trading assets by $18 million, which is reflected in earnings (Wells Fargo).

All 47 early adoption banks disclosed the dollar amounts of the impacts of FSP FAS 115-2 and FAS 124-2 on their financial statements. On average, an early adoption bank made a one-time adjustment of $27 million to retained earnings (equivalent to 0.6% of total stockholders' equity) upon the adoption of the new standard in the quarter ending on March 31, 2009. The adjustment transferred other-than-temporary impairments (OTTI) unrelated to credit losses out of retained earnings into the AOCI account, which increased retained earnings and decreased AOCI. The early adoption banks also recorded on average $47 million (equivalent to 62% of their quarterly net income) of other than temporary impairments (OTTI) unrelated to credit loss in AOCI rather than on the income statement. For example, Wells Fargo increased the beginning balance of retained earnings by $85 million ($53 million after tax) with a corresponding adjustment to AOCI at the adoption of FSP FAS 115-2 and FAS 124-2. It also charged $334 million of OTTI unrelated to credit loss to AOCI during the first quarter of 2009, which increased its quarterly net income.

Overall, banks' disclosure demonstrates that the new fair value guidance had a favorable effect on the early adoption banks' financial statements in terms of improved earnings and asset valuation. We present detailed analysis of the impact of the new guidance in the following two sections. We also conduct logistic regression analysis on factors that may affect banks' early adoption decisions. The regression results show that the early adoption banks have more assets carried at fair value than the non-early adoption banks and provide evidence that banks' early adoption decisions might be motivated by the incentives to boost core capital ratios and to avoid reporting losses. Our study makes a timely examination of the impact of the

[2] Other than the disclosure requirement, FSP FAS 107-1 and APB 28-1 does not affect account balances on the financial statements. For this reason, the current study focuses on FSP FAS 157-4 and FSP FAS 115-2 and FAS 124-2.

new fair value guidance on banks' financial statements. The findings provide information for standard setters and regulators to evaluate the effects of this important and controversial guidance on fair value accounting.

The next section discusses the background of the new fair value guidance. We then present data on the impact of the new guidance on early adoption banks' financial statements. Section 4 contains regression analysis on the factors that affected banks' early adoption decisions. The final section presents conclusions and implications.

BACKGROUND INFORMATION ON NEW FAIR VALUE GUIDANCE

During the financial crisis in 2008, there had been intense controversy over fair value accounting. The financial institutions complained that mark-to-market accounting required them to mark down assets at depressed prices, which depleted their capital and forced them to liquidate their positions in a disrupted market. The banking industry argued that fair value accounting increased the systemic risk in the financial market and lobbied the Congress to suspend or change the accounting standard (Joseph-Bell et al. 2008; Johnson 2008). In response to the alleged negative effects of fair value accounting, the Emergency Economic Stability Act of 2008 (EESA) granted the Securities and Exchange Commission (the SEC) the authority to suspend SFAS (Statement of Financial Accounting Standards) 157, *Fair Value Measurements*,[3] when it is deemed necessary for the protection of the public interest (EESA Section 132) and directed the SEC to conduct a study on fair value accounting (EESA Section 133). The SEC issued its study in December 2008 and recommended modifications of fair value accounting rules in areas involving determination of fair value in illiquid or inactive markets and recognition of impairment losses (SEC 2008). FASB subsequently issued the new fair value guidance in April 2009.

Investor advocates expressed concerns that "This is a political interference on a major issue, and it raises questions about whether accounting standards going forward will have the quality and integrity that the market needs" (Pulliam and McGinty 2009). Similarly, the Financial Crisis Advisory Group (FCAG), an advisory group for the International Accounting Standards Board (IASB) and the US FASB, noted in a report that "In April 2009, under pressure that the US Congress would change accounting standards by legislation, the FASB accelerated its normal due process before issuing guidance in several fair value areas….we have become increasingly concerned about the excessive pressure … to make rapid, piecemeal, uncoordinated and prescribed changes to standards" (FCAG 2009).

The new fair value guidance includes FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly,* FSP FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments,* and FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments.* The three FSPs are effective for

[3] SFAS 157 establishes a three-level fair value hierarchy to prioritize the inputs used to measure fair value. Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Level 2 inputs are observable inputs other than those classified in Level 1, including quoted prices for similar assets or liabilities, quoted prices in less active markets, or other observable inputs that can be corroborated by observable market data. Level 3 inputs are unobservable inputs that "reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability". Significantly adjusted market prices are categorized as level 3 inputs. Companies are required to maximize the use of observable inputs and minimize the use of unobservable inputs in fair value measurement.

reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. Companies are required to simultaneously adopt all three FSPs if they elect to early adopt.

FSP FAS 157-4 provides guidance for estimating fair value in accordance with SFAS 157, *Fair Value Measurements*, when the volume and level of activity for the asset or liability has significantly decreased. The FSP also includes guidance on identifying circumstances that indicate a transaction is not orderly. Under these circumstances, transactions or quoted prices may not be determinative of fair value. Firms may need to make significant adjustments to quoted prices and/or use alternative valuation techniques to determine the fair value of the asset or liability under current market conditions. However, FSP FAS 157-4 emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions.

In paragraph 29A – 29H, FSP FAS 157-4 lists a number of factors, such as "few recent transactions", price quotations "not based on current information", and "significant decline or absence of a market for new issuances for the asset or liability or similar assets or liabilities", as conditions to consider in determining whether there is a significant decrease in the volume and level of activity. When there is a significant decrease in the volume and level of activity for the asset or liability, "quoted prices may not be determinative of fair value" and "a change in valuation technique or the use of multiple valuation techniques may be appropriate". The FSP requires firms to place little, if any, weight on prices for transactions that are not orderly. As a result, quoted prices may no longer be appropriate inputs when they do not reflect orderly transactions or the markets are inactive due to a significant decrease in volume or level of activity. An implication of the provision is that firms might be able to obtain a higher valuation for their assets using unobservable inputs and valuation models than using the distressed market prices. Five of the early adoption banks in our sample disclosed information on the effect of the guidance on fair value measurements. For example, M & T Bank Corp disclosed in its 2009 first quarter 10-Q:

> "Due to the severe disruption in the credit markets during the second half of 2008 and continuing into 2009, trading activity for privately issued mortgage-backed securities was dramatically reduced… FSP 157-4 provided additional guidance for estimating fair value when the volume and level of trading activity for the asset or liability have significantly decreased. In consideration of the new FASB guidance, the Company performed internal modeling to estimate the cash flows and fair value of 121 of its privately issued residential mortgage-backed securities with an amortized cost basis of $2.3 billion at March 31, 2009…The average weight placed on internal model valuations was 37%, compared with a 63% weighting on valuations provided by the independent sources. The highest and lowest weights placed on internal valuations were 40% and 0%. The impact of adopting FSP 157-4 and using an internal valuation modeling technique was to increase accumulated other comprehensive income at March 31, 2009 by $142 million ($233 million pre-tax)." (M & T Bank Corp)

FSP FAS 115-2 and FAS 124-2 amends guidance for the measurement and recognition of other-than-temporary impairments (OTTI) for debt securities. Under the FSP, if a company

does not intend to sell, and it is more likely than not that the company will not be required to sell, a security before the recovery of its cost basis, the company must evaluate whether an OTTI has occurred. If the present value of cash flows that is expected to be collected from the security is less than its amortized cost basis, the company should recognize an OTTI.

FSP FAS 115-2 and FAS 124-2 separates debt securities OTTI into OTTI related to credit loss and OTTI related to other factors. "The amount of the total other-than-temporary impairment related to the credit loss is recognized in earnings (or the performance indicator). The amount of the total impairment related to all other factors is recognized in other comprehensive income (or outside the performance indicator)" (Paragraph 9). Compared with the superseded accounting practice of charging all OTTI to current earnings, the application of the new standard results in higher net income by shifting impairment losses unrelated to the credit loss to other comprehensive income (OCI). In addition to increased earnings, the new rule also has a positive effect on banks' core capital, because Tier 1 (core) capital includes retained earnings but not AOCI.[4] For example, Harrington West Financial Group disclosed in its 2009 first quarter 10-Q:

> "as a result of implementing the new rule, the amount of OTTI recognized in income was $2.1 million. Had the rule not been implemented, the full amount of the unrealized fair value decline in the value of the securities with OTTI of $3.9 million would have been recognized in income" (Harrington).

For debt securities held at the beginning of the interim period of adoption for which an OTTI was previously recognized, a company should record a one-time adjustment for the cumulative effect of initially applying FSP FAS 115-2 and FAS 124-2. The adjustment increases the opening balance of retained earnings with a corresponding decrease to accumulated other comprehensive income (AOCI). For example, Harrington West Financial Group stated in its 2009 first quarter 10-Q:

> "Through the year ended December 31, 2008, the Company recognized a total other -than-temporary impairment charge of $14.0 million for various securities. At adoption of this FSP, the Company reversed $1.5 million (gross of tax) of this impairment charge, representing the non-credit portion, which resulted in a $12.5 million gross impairment charge related to credit at January 1, 2009" (Harrington).

FSP FAS 107-1 and APB 28-1 requires disclosures about fair value of financial instruments for interim reporting periods as well as in annual financial statements. Companies are required to disclose the methods and significant assumptions used to estimate the fair value of financial instruments in financial statements and to highlight any changes from prior periods. Since the adoption of this FSP does not have any impact on financial statements other than the disclosure requirement, the current study does not further examine this guidance.

[4] Banks' Tier 1 (core) capital consists of common stockholders' total equity (i.e. common stock, additional paid-in capital and retained earnings), noncumulative perpetual preferred stock, and cumulative preferred stock (to a maximum of 25 percent), plus minority interests in the equity capital accounts of consolidated subsidiaries, less goodwill and other intangible assets. It does not include AOCI.

DESCRIPTIVE ANALYSIS ON THE IMPACT OF NEW FAIR VALUE GUIDANCE

Sample Selection

Our initial sample consists of 663 commercial banks and saving and depository institutions (SIC code 6000-6099) in the COMPUSTAT quarterly report database as of August 31, 2009. We hand-collected information on the early adoption decisions and the effect of the early adoption on financial statements from the banks' 10-Q filings for the quarter ending on March 31, 2009 in the SEC EDGAR historical filings database. We drop 265 banks from the sample due to lack of fair value related data items and information on the adoption of the new accounting guidance. Our final sample consists of 398 banks. There are 47 banks that early adopted the new guidance, and the other 351 banks chose to adopt the guidance in the second quarter of 2009.

Table 1 summarizes the definitions of the variables in our study. In addition to a dummy variable coded as 1 for early adopters and 0 for non-early adopters, there are roughly three groups of variables: 1) variables measuring basic bank characteristics including size, profitability, leverage, Tier 1 capital ratio, and stock returns; 2) variables related to assets and liabilities carried at fair value; 3) variables about bank's disclosure on the impact of new guidance on their financial statements. We also included two variables as proxies of earnings management.

Table 1
Variable Definitions

Variable	Definition
EarlyAdopt	A dummy variable which equals 1 if a bank chose to early adopt the new fair value guidance in the quarter ending March 31, 2009 and 0 otherwise. The information on banks' early adoption decisions is hand collected from banks' 10-Q filings.
AT	Total assets (COMPUSTAT data item ATQ) in millions on March 31, 2009
NI	Quarterly net income in millions (COMPUSTAT data item NIQ) for the quarterly ending on March 31, 2009
ROA	Return on assets calculated as the ratio of quarterly net income over total assets for the quarterly ending on March 31, 2009
ROAadj	Return on assets removing the effect of the fair value guidance.
CAPR1	Tier one risk-adjusted capital ratio (COMPUSTAT data item CAPR1Q) in percentage point for the quarter ending on March 31, 2009
CAPR1adj	Tier one risk-adjusted capital ratio removing the effect of the fair value guidance for the quarterly ending on March 31, 2009
Leverage	The ratio of total liabilities over total shareholders' equity for the quarter ending on March 31, 2009
Leverageadj	The ratio of total liabilities over total shareholders' equity removing the effect of the fair value guidance for the quarterly ending on

	March 31, 2009
Return	Stock return during the quarter ending on March 31, 2009. Stock return is obtained from CRSP monthly stock return data.
FVA (FVL)	All assets (liabilities) measured at fair value (COMPUSTAT data item TFVAQ (TFVLQ)) for the quarter ending on March 31, 2009.
FVA1 (FVL1)	Total fair value assets (liabilities) measured by level 1 inputs (COMPSTAT data item AQPL1Q (LQPL1Q)) for the quarter ending on March 31, 2009.
FVA2 (FVL2)	Total fair value assets (liabilities) measured by level 2 inputs (COMPSTAT data item AOL2Q (LOL2Q)) for the quarter ending on March 31, 2009.
FVA3 (FVL3)	Total fair value assets (liabilities) measured by level 3 inputs (COMPSTAT data item AUL3Q (LUL3Q)) for the quarter ending on March 31, 2009.
FVA/AT (FVL/AT)	All assets (liabilities) measured at fair value deflated by total assets (COMPUSTAT data item ATQ) on March 31, 2009.
FVA1/AT (FVL1/AT)	Total fair value assets (liabilities) measured by level 1 inputs deflated by total assets (COMPUSTAT data item ATQ) on March 31, 2009.
FVA2/AT (FVL2/AT)	Total fair value assets (liabilities) measured by level 2 inputs deflated by total assets (COMPUSTAT data item ATQ) on March 31, 2009.
FVA3/AT (FVL3/AT)	Total fair value assets (liabilities) measured by level 3 inputs deflated by total assets (COMPUSTAT data item ATQ) on March 31, 2009.
Δtrading	The effect of adopting FSP FAS 157-4 on the fair value measurement of trading securities
ΔAFSHTM	The effect of adopting FSP FAS 157-4 on the fair value measurement of available-for-sale and hold-to-maturity securities
Δtrading/NI	The ratio of the effect of adopting FSP FAS 157-4 on the fair value measurement of trading securities deflated by net income (COMPUSTAT data item NIQ) for the quarterly ending on March 31, 2009
ΔtradingAFSHTM/EQ	The ratio of the effect of adopting FSP FAS 157-4 on the fair value measurement of trading, available-for-sale, and hold-to-maturity securities deflated by total stockholders' equity (COMPUSTAT data item SEQQ) on March 31, 2009.
ImpCumAdj	The one-time adjustment in millions (hand collected from 10-Q filing) to increase beginning retained earnings and decrease accumulated other comprehensive income (AOCI) account made at the adoption of FSP FAS 115-2 and FAS 124-2 to remove the cumulative impairment losses not related to the credit loss from retained earnings to AOCI

ImpNCLCurr	The amount of non-credit loss related other than temporary impairments (OTTI) in millions (hand collected from 10-Q filing) that are required to be charged to the other comprehensive income according to FSP FAS 115-2 and FAS 124-2
ImpCLCurr	The amount of credit loss related other than temporary impairments (OTTI) in millions (hand collected from 10-Q filing) that are required to be charged to the current earnings according to FSP FAS 115-2 and FAS 124-3
ImpNCLCurr/NI	The ratio of ImpNCLCurr over total quarterly net income for the quarterly ending on March 31, 2009
TargetZero	A dummy variable that equals 1 if a bank is identified as potentially managing earnings to avoid reporting losses. Following Burgstahler and Dichev (1997), a bank is assumed to manage earnings to avoid reporting losses if its quarterly earnings per share (COMPUSTAT data item EPSFXQ) deflated by beginning stock price (COMPUSTAT data item PRCCQ) is between 0 and 0.01.
TargetIncrease	A dummy variable that equals 1 if a bank is identified as potentially managing earnings to avoid a decrease in earnings over prior period level. A bank is assumed to manage earnings to avoid a decrease in earnings if its current quarter earnings per share (COMPUSTAT data item EPSFXQ) minus its earnings per share for the same quarter of prior year deflated by stock price (COMPUSTAT data item PRCCQ) at beginning of the prior period is between 0 and 0.01.

Sample Descriptive Statistics

Table 2 presents descriptive statistics for the 47 early adoption banks and the 351 non-early adoption banks in Panel A and Panel B, respectively. Panel C compares the means of the variables between the two groups of banks and presents the significance of t-test and Wilcoxon test. The average (median) total assets for the early adopting banks are $148.251 ($3.041) billion, which is about 25 (two) times larger than the average (median) total assets of $5.865 ($1.295) billion for the non-early adopting banks. The big difference between the mean and median total assets of the early adoption banks indicates the existence of a few very large banks and the need to control for outliers in the subsequent empirical tests. The median quarterly net income is similar for the two groups of banks (around $1 million), while the mean earnings is $217 million for early adoption banks and -$8.33 million for non-adoption banks. The disparity between the means of net income may be caused by the earnings reported by a few extremely large banks. After we control for bank size by scaling net income over total assets, the two groups of banks have roughly the same level of ROA (return on assets). The mean and median ROA is -0.03 and 0.08 percent for both early adopters and non-early adopters. In fact, about 70 percent of our sample banks are profitable for the quarter. Early adoption banks have an average Tier 1 risk-adjusted capital ratio of 10.95%, which is not significantly different from that of 11.49% for non-early adopting banks. The mean leverage ratio (i.e. debt to equity ratio) for early and non-early adopters is 11.36 and 8.71, respectively, not statistically different. Both groups of banks had poor stock returns during the quarter ending on March 31, 2009. However, the average return of -29.84% for early adopting banks is significantly lower than that of -18.78% for non-early adopting banks.

The early adoption banks have more assets and liabilities measured at fair value on a recurring basis than the non-early adoption banks. The mean total assets (liabilities) carried at fair value on a recurring basis for the early adopters are $157.338 ($122.403) billion, much more than that of $1.149 billion ($88 million) for the non-early adopters. To facilitate comparison across the banks, we scale the dollar amount of fair value balances by total assets. The scaled measures show that fair value assets (liabilities) account for on average 24.99 (6.26) percent of total assets for early adopters, which is significantly higher than that of 15.92 (0.23) percent for non-early adopters. The majority of the fair value assets and liabilities are classified in the level 2 category. Level 2 assets (liabilities) account for on average 21.89 (5.85) percent of total assets for the early adoption banks and on average 14.72 (0.18) percent for non-early adoption banks. None of the other fair value items (level 1 and level 3 assets and level 1 and level 3 liabilities) accounts for more than 1.6% of total assets for both groups of banks.

Table 2
Summary Statistics
Panel A: Early adoption banks

	Mean	Std. Deviation	Quartile 1	Median	Quartile 3	N
AT	148,251	494,766	1,104	3,041	15,912	47
LogAT	8.72	2.24	7.00	8.02	9.67	47
NI	217	848	0	1	11	47
ROA	-0.03	0.41	-0.01	0.08	0.17	47
CAPR1	10.95	2.03	9.32	11.03	12.04	47
Leverage	11.36	4.71	8.49	10.61	12.25	47
Return	-29.84	21.12	-41.09	-31.21	-16.76	47
FVA	157,338	667,597	201	570	3,387	47
FVL	122,403	545,958	0	2	93	47
FVA1	10,708	52,948	0	4	46	47
FVA2	138,632	591,731	158	527	2,817	47
FVA3	7,999	29,786	3	15	220	47
FVL1	3,007	13,115	0	0	0	47
FVL2	116,597	521,247	0	1	93	47
FVL3	2,799	12,309	0	0	1	47
FVA/AT	24.99	27.95	12.30	17.95	25.64	47
FVL/AT	6.26	24.82	0.00	0.10	0.84	47
FVA1/AT	1.352	4.063	0.003	0.088	0.346	47
FVA2/AT	21.892	25.262	9.814	15.101	23.519	47
FVA3/AT	1.572	2.410	0.123	0.651	1.815	47
FVL1/AT	0.202	0.696	0.000	0.000	0.000	47
FVL2/AT	5.846	23.702	0.000	0.054	0.610	47
FVL3/AT	0.217	0.633	0.000	0.000	0.004	47

Panel B: Non-early adoption banks

	Mean	Std. Deviation	Quartile 1	Median	Quartile 3	N
AT	5,865	19,056	654	1,295	3,408	351
LogAT	7.44	1.29	6.48	7.17	8.13	351
NI	-8.33	144.49	-0.79	0.78	2.94	351
ROA	-0.03	0.49	-0.10	0.08	0.17	351
CAPR1	11.49	3.00	9.71	11.25	13.25	351
Leverage	8.71	48.17	7.99	9.81	12.01	351
Return	-18.78	26.41	-35.14	-17.15	-4.52	351
FVA	1,149	4,862	82	174	529	351
FVL	88	705	0	0	1	351
FVA1	83	601	0	0	5	351
FVA2	992	3,865	74	160	502	351
FVA3	74	618	0	0	4	351
FVL1	3	32	0	0	0	351
FVL2	72	583	0	0	1	351
FVL3	13	182	0	0	0	351
FVA/AT	15.92	10.10	8.53	14.28	21.07	351
FVL/AT	0.23	0.87	0.00	0.00	0.05	351
FVA1/AT	0.80	2.61	0.00	0.01	0.20	351
FVA2/AT	14.719	9.757	7.639	13.358	19.767	351
FVA3/AT	0.388	1.264	0.000	0.000	0.206	351
FVL1/AT	0.004	0.032	0.000	0.000	0.000	351
FVL2/AT	0.181	0.733	0.000	0.000	0.016	351
FVL3/AT	0.045	0.311	0.000	0.000	0.000	351

Panel C: Compare Early-Adoption and Non-early adoption banks

	Means for early adoption firms	Means for early non-adoption firms	Difference	T-test	Wilcoxon test
AT	148,251	5,865	142,387	***	***
LogAT	8.72	7.44	1.27	***	***
NI	217	-8	226	***	***
ROA	-0.03	-0.03	0		
CAPR1	10.95	11.49	-0.53		
Leverage	11.36	8.71	2.65		
Return	-29.84	-18.78	-11.06	***	***
FVA	157,338	1,149	156,189	***	***
FVL	122,403	88	122,315	***	***
FVA1	10,708	83	10,625	***	***
FVA2	138,632	992	137,640	***	***

FVA3	7,999	74	7,925	***	***
FVL1	3,007	3	3,004	***	***
FVL2	116,597	72	116,525	***	***
FVL3	2,799	13	2,786	***	***
FVA/AT	24.99	15.92	9.07	***	***
FVL/AT	6.26	0.23	6.03	***	***
FVA1/AT	1.352	0.803	0.549		
FVA2/AT	21.892	14.719	7.173	***	***
FVA3/AT	1.572	0.388	1.185	***	**
FVL1/AT	0.202	0.004	0.198	***	***
FVL2/AT	5.846	0.181	5.666	***	***
FVL3/AT	0.217	0.045	0.173	***	***

The banks generally provide in their 10-Qs an assessment of the impact of the new guidance on their financial statements. Twenty six percent (12 out of 47) of early adoption banks stated that FSP FAS 157-4 had a significant impact on their 2009 quarter one financial statements, and 79 percent (37 out of 47) stated that FSP FAS 115-2 and FAS 124-2 had a significant impact on their financial statements.[5] On the other hand, only one (three) out of 351 non-early adopters expected FSP FAS 157-4 (FSP FAS 115-2 and FAS 124-2) to have a significant impact on their financial statements when they adopt the guidance in the second quarter of 2009. Of the 351 non-early adopters, a little over half stated that they expect the adoption of the two FSPs (i.e. FSP FAS 157-4 and FSP FAS 115-2 and FAS 124-2) to have no significant impact on their financial statements, and close to half stated that they were still evaluating the impact of the new guidance at the time of the first quarter of 200910-Q filing. The statistics show that the fair value guidance had substantial effect on about 80 percent of the early adoption banks' financial reports. In contrast, only one percent of the non-early adoption banks had determined that the new standards will have a significant effect on their financial reports when it becomes effective in the second quarter of 2009.

[5] Among the early adoption banks, 11 banks acknowledged in their 10-Qs that both FSP FAS 157-4 and FSP FAS 115-2 and FAS 124-2 had significant impacts on their financial statements; 26 banks acknowledged that FSP FAS 115-2 and FAS 124-2 had significant impacts on their financial statements; and one bank acknowledged that FSP FAS 157-4 had significant impacts on their financial statements.

Table 3

Banks' Assessment of Impact of the Fair Value Guidance

Panel A: Banks' Assessment of Impact of FSP 157-4

	Early Adoption Banks		Non-Early Adoption Banks	
	Number of Banks	Percentage	Number of Banks	Percentage
Total Number of Banks	47	100%	351	100%
Materials Effects on Financial Statements	12	25.5%	1	0.3%
No Materials Effects on Financial Statements	35	74.5%	197	56.1%
Still Assessing Effects on Financial Statements	Not Applicable		153	43.6%

Panel B: Banks' Assessment of Impact of FSP 115-2 and 124-2

	Early Adoption Banks		Non-Early Adoption Banks	
	Number of Banks	Percentage	Number of Banks	Percentage
Total Number of Banks	47	100%	351	100%
Materials Effects on Financial Statements	37	78.7%	3	0.9%
No Materials Effects on Financial Statements	10	21.3%	181	51.6%
Still Assessing Effects on Financial Statements	Not Applicable		167	47.6%

Impact of FSP FAS 157-4 on Asset Valuation

Only five banks (i.e. Wells Fargo, Bank of New York Mellon, M&T Bank, Comerica Inc., and Dime Community Bancshares) disclosed information on the impact of FSP FAS 157-4 on fair value of their assets and liabilities. Table 4 summarizes the effect of FSP FAS 157-4 on these five banks. As shown in Panel A of Table 4, the application of FSP FAS 157-4 leads to higher fair value measurement of trading securities for one bank (Wells Fargo) and higher fair value measurement of available-for-sale and hold-to-maturity securities for all five banks. Under GAAP, changes in the value of trading securities are recognized in current net income, and

changes in the value of available-for-sale and hold-to-maturity securities are classified as other comprehensive income (OCI) and charged to AOCI on the balance sheet. Therefore, appreciation of available-for-sale and hold-to-maturity securities increases total stockholders' equity and favorably affects the leverage ratio, but has minimal effect on banks' core capital, because core capital includes retained earnings but not AOCI. The gain or reduced loss from the higher valuation of trading securities accounts for 0.59 percent of Wells Fargo's quarterly net income. The increases on total stockholders' equity from higher valuation of available-for-sale and hold-to-maturity securities range from a high of 2.81 percent to the minimum of 0.36 percent. As shown in Panel B of Table 4, the application of FSP FAS 157-4 decreased on average the five banks' leverage ratio from 9.79 to 9.65. Unfortunately, given the limited number of observations, statistical measures of the difference is not available. Economically, the decrease of 0.14 from a base of 9.79 does not seem to be significant.

Table 4

Impact of FSP FAS 157-4 on Early Adoption Banks' Earnings and Leverage

Panel A: Statistics on FSP 157-4's Effect on Fair Value

	Wells Fargo	**New York Mellon**	**M & T Bank**	**Comerica, Inc**	**Dime Community**
ΔTrading (in millions)	18	0	0	0	0
ΔAFSHTM (in millions)	2,800	519	142	36	1
ΔTrading/NI	0.59%	0	0	0	0
ΔTradingAFSHTM/EQ	2.81%	2.06%	1.84%	0.50%	0.36%

Panel B: Effect of FAS 157-4 on Leverage Ratio

	As Reported	**If without FAS 157-4**	**Effect of FAS 157-4 (Difference)**
Mean Leverage Ratio for the 5 Banks	9.65	9.79	-0.14

Impact of FSP FAS 115-2 and FAS 124-2 on Earnings and Core Capital

All early adoption banks provided detailed information on the effect of FSP FAS 115-2 and FAS 124-2 on their earnings and stockholders' equity. Table 5 contains the statistics on the impacts of FSP FAS 115-2 and FAS 124-2 on the early adoption banks' financial statements. Panel A shows that the reclassification of OTTI unrelated to credit loss (ImpNCLCurr) on average increased net income of the early adoption banks by $47 million, which accounts for 62 percent of their first quarter earnings. As shown in Panel B, the ratio of Non-credit loss related OTTI and net income (ImpNCLCurr/NI) exceeds 1 for 9 of the 47 early adoption banks, which means that these nine banks would have reported a loss without the earnings increases from the reclassification of OTTI unrelated to credit loss. The ImpNCLCurr/NI ratio is in the 0.5 to 1 range for 4 banks, indicating that the earnings of these four banks were improved by over 50%.

Twenty one banks either improved earnings by up to 50% or reduced losses. The rest 13 banks reported zero non-credit loss related OTTI.

As a result of the reclassification of non-credit loss related OTTI, the average ROA of the early adoption banks increased from -0.18 percent to -0.03 percent. This increase is statistically significant. Without the effect of FSP FAS 115-2 and FAS 124-2, the average ROA of early adoption banks would have been significantly lower than that of non-early adopters. The application of FSP FAS 115-2 and FAS 124-2 increased the proportion of early adoption banks that reported a small profit from 19.15 percent to 27.66 percent, which exceeds the 14.25 percent for the non-early adoption banks. The application of FSP FAS 115-2 and FAS 124-2 also increased the proportion of early adoption banks that reported an increase over prior period earnings from 10.64 percent to 12.77 percent, which is still lower than the 19.66 percent for the non-early adoption banks. The statistics demonstrate that the application of FSP FAS 115-2 and FAS 124-2 had a significant favorable effect on banks' profitability, which is consistent with financial analysts' estimates on the effect of FSP FAS 115-2 and FAS 124-2 on financial statements.[6]

As shown in Table 5, early adoption banks on average made a one-time adjustment of $27 million upon the adoption of the new standard in the first quarter of 2009. The adjustment transferred other-than-temporary impairments (OTTI) unrelated to credit losses out of retained earnings into AOCI, which increased retained earnings and decreased AOCI. The adjustment increases banks' core capital, but did not affect total stockholders' equity. As discussed above, the reclassification of OTTI unrelated to credit loss (ImpNCLCurr) increased earnings and thus also affects core capital. Overall, the application of FSP FAS 115-2 and FAS 124-2 increased the early adoption banks' Tier 1 capital ratio from 10.75 percent to 10.96 percent. Without the effect of FSP FAS 115-2 and FAS 124-2, the early adoption banks would have a significantly lower Tier 1 capital ratio than the non-early adoption banks.

Table 5

Impact of FSP FAS 115-2 and FAS 124-2 on Early Adoption Banks' Earnings and Capital

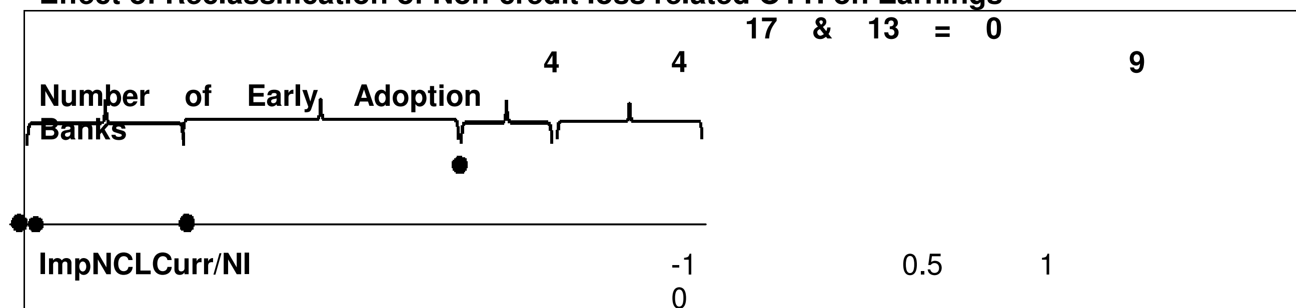
Panel A: Statistics on Impairment Loss Items

	Mean	**Std. Deviation**	**Quartile 1**	**Median**	**Quartile 3**
ImpNCLCurr (in millions)	47	202	0	1	5
ImpCumAdj (in millions)	27	105	0	1	5
ImpNCLCurr/NI	0.62	4.82	0.00	0.00	0.45

[6] Among the early adoption banks, 11 banks acknowledged in their 10-Qs that both FSP FAS 157-4 and FSP FAS 115-2 and FAS 124-2 had significant impacts on their financial statements; 26 banks acknowledged that FSP FAS 115-2 and FAS 124-2 had significant impacts on their financial statements; and one bank acknowledged that FSP FAS 157-4 had significant impacts on their financial statements.

Panel B: Impact of FSP FAS 115-2 and FAS 124-2 on Earnings

Effect of Reclassification of Non-credit loss related OTTI on Earnings



Effect of Reclassification of Non-credit loss related OTTI on ROA and Proxies of Earnings Management

	Adoption Banks - As Reported	Adoption Banks – If without FAS 115-2	Effect of FAS 115-2 (Difference)	Non-early Adoption Banks
ROA	-0.03%	-0.18%	0.15%***	-0.03%
TargetZero (number of banks)	27.66%	19.15%	8.51%	14.25%
	13 out of 47	9 out of 47		50 out of 351
TargetIncrease (number of banks)	12.77%	10.64%	2.13%	19.66%
	6 out of 47	5 out of 47		69 out of 351

Panel C: Impact of FSP FAS 115-2 and FAS 124-2 on Tier 1 Capital Ratio

	As Reported	If without FAS 115-2	Effect of FAS 115-2 (Difference)
Mean CAPR1 for Early adopters	10.96%	10.75%	0.21%
Mean CAPR1 for Non-early Adopters	11.49%	11.49%	
Difference	-0.53%	-0.74%**	

In summary, as indicated in the banks' disclosures, the new fair value guidance generally had favorable effects on the early adopters' financial statements. Application of FSP FAS 157-4 enables banks to use their own estimates in replace of distressed market prices to determine fair value of their assets in times of market depression, which helped at least some of the early adoption banks to maintain assets valuation and reduce unrealized losses (or increase unrealized gains). The application of FSP FAS 115-2 and FAS 124-2 substantially increased the early adoption banks' reported earnings through charging OTTI unrelated to credit loss to AOCI rather than to current earnings. In addition, banks made a one-time adjustment at the adoption of FSP FAS 115-2 and FAS 124-2, which increased retained earnings and decreased AOCI.

REGRESSION ANALYSIS ON EARLY ADOPTION OF THE NEW GUIDANCE

Factors related to Banks' Early Adoption Decisions

We conduct regression analysis to explore the factors that may affect banks' early adoption decisions. Since the passage of the guidance on April 9, 2009 to the dates of 10-Q filings in late April and early May, banks had limited time to study the new guidance and assess its potential impact on financial statements. The amount of corporate resources available to the financial reporting function largely determines the feasibility of making prompt adoption decisions. Large banks which possess more resources and human talent are more capable of implementing the new guidance in a timely fashion (Holthausen and Leftwich 1983). Therefore, we include bank size in the regression to account for the difference in corporate resources available to financial reporting function across banks.

The fair value guidance is likely to have a bigger impact on the financial reporting of banks that that carry more assets and liabilities at fair value. Therefore, we control for the amount of assets and liabilities in the level 1, level 2, and level 3 categories. We deflated the balances of each item by total assets to facilitate the comparison of the weight of fair value measured assets and liabilities across the banks.

Banks are closely regulated by state and federal agencies which generally impose strict requirements on capital reserve levels.[7] The reclassification of OTTI unrelated to credit loss and valuation of the trading securities directly affects banks' core capital. The banking industry had struggled through a period of huge assets write-downs and was under heavy pressure to shore up their capital. We expect banks with lower core capital ratios to be more likely to early adopt the new guidance. The argument is consistent with Nissim (2003) who finds regulatory capital requirements affect the degree of overstated bank loans. To investigate the effect of the new guidance on financial reports, we adjust the reported Tier 1 capital ratio to obtain the Tier 1 capital ratio if without the application of the guidance. We also control for the leverage ratio in the regression, which also adjusted for the effect of the fair value guidance.

Some banks recorded large losses during the peak of the financial crisis in 2008. Investors worried that these banks might go bankrupt if they did not begin reporting profits in 2009 (Pulliam and McGinty 2009). We examine the association between profitability and the adoption decision by including ROA that is adjusted by the effect of the new guidance in the regression. In addition, we follow the approach of Burgstahler and Dichev (1997) to identify earnings management to meet earnings benchmarks. We investigate whether banks' early adoption decisions are motivated by the incentives to avoid reporting losses and/or to avoid decreases over prior period earnings.[8] As shown in Table 5, a substantial proportion of our sample banks reported a small profit and an increase over prior period earnings. The

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[7] Federally insured savings institutions are required to maintain minimum levels of regulatory capital. Under applicable regulations, an institution is well capitalized if it has a total risk-adjusted capital ratio of at least 10.0% and a Tier 1 risk-adjusted capital ratio of at least 6.0%. An institution is adequately capitalized if it has a total risk-adjusted capital ratio of at least 8.0% and a Tier 1 risk-adjusted capital ratio of at least 4.0%. Regulators may require extra capital reserves under certain conditions. For example, Federal Deposit Insurance Corporation (FDIC) requires many banks to allocate extra capital for their mortgage bond holdings that are rated below investment grade (Scism and Tamman 2010).

[8] We do not include a measure for earnings management to meet analyst earnings forecasts because analyst forecasts are not available for over half of our sample banks.

application of the new guidance also increased the number of early adoption banks that just avoided reporting a loss or a decrease over prior period earnings. Stock performance reflects investors' perception of banks' financial health and future operating performance. We control for the stock returns during the first quarter of 2009 in the regression.

Logit Regression Analysis

We examine the factors that may affect banks' early adoption decisions using a logit regression. The logit model is specified as follows (variables are defined in Table 1):

$$\begin{aligned} EarlyAdopt &= \alpha_0 + \alpha_1 \log AT + \alpha_2 FVA1/AT + \alpha_3 FVA2/AT + \alpha_4 FVA3/AT \\ &+ \alpha_5 FVL1/AT + \alpha_6 FVL2/AT + \alpha_7 FVL3/AT + \alpha_8 CAPR1adj + \alpha_9 Leverageadj \\ &+ \alpha_{10} ROAadj + \alpha_{11} TargetZero + \alpha_{12} TargetIncrease + \alpha_{13} Return + \varepsilon \end{aligned} \quad (1)$$

The Tier 1 capital ratio, leverage ratio and ROA in the model are all adjusted for the effect of the adoption of FSP FAS 157-4 and FSP FAS 115-2 and FAS 124-2. The adjusted variables represent the banks' core capital level, profitability and leverage if without the application of the fair value guidance. Using these variables controls for the effect of the new guidance on financial statements and enables us to investigate how banks' concerns with their earnings and capital affected their early adoption decisions.

Table 6 contains the regression results. The dependent variable EarlyAdopt has significant positive associations with FVA2/AT (p-value < 0.01) and FVA3/AT (p-value < 0.01). The results demonstrate that the early adoption banks have substantially more level 2 and level 3 assets than the non-early adoption banks. Given the favorable effects of the adopted guidance on earnings and core capital as disclosed in banks' 10-Qs, the results suggest that banks with more assets carried at fair value stand to take more benefits from the guidance and thus are more likely to early adopt the guidance. We do not find any significant association between the dependent variable and the other categories of fair value assets and liabilities. The proxy for bank size, logAT, is not significantly associated with EarlyAdopt. The insignificance of the variable may be partly attributed to our deflating the fair value assets and liabilities variables by total assets.

Table 6
Logit Analysis of Factors Affecting Early Adoption of the New Fair Value Guidance

Variable	Coefficient	P-value
Intercept	-2.63	0.04
LogAT	0.13	0.36
FVA1/AT	0.03	0.64
FVA2/AT	**0.06**	**<0.01**
FVA3/AT	**0.29**	**<0.01**
FVL1/AT	1.96	0.53
FVL2/AT	0.07	0.73
FVL3/AT	0.20	0.69
CAPR1adj	**-0.19**	**<0.01**
Leverageadj	0.01	0.18

ROAadj	-0.28	0.33
TargetZero	**1.18**	**<0.01**
TargetIncrease	-1.09	0.12
Return	-1.28	0.12
Number of observations = 398		

Association of Predicted Probabilities and Observed Responses	
Percent Concordant = 80.6	
Somer's D = 0.62	
Testing BETA = 0:	
Likelihood ratio test	P-value < 0.01
Score test	P-value < 0.01
Wald test	P-value < 0.01

We also document significant positive associations between EarlyAdopt and the variables CAPR1adj (p-value = 0.01) and TargetZero (p-value < 0.01). Leverageadj, ROAadj TargetIncrease, and Return are not significant. The results suggest that banks' early adoption decisions may be motivated by the incentives to raise core capital reserves and to avoid reporting losses. The findings are consistent with the reports in financial press that some banks may not survive the financial crisis if they could not stop losses and start reporting profits (Pulliam and McGinty 2009). The Percent Concordant of the logit model is 80.6%, and Somer's D is 0.62. The goodness of fit statistics demonstrates a fairly strong predicting power of our model.

Sensitivity Analysis

It is well known that the biggest four US banks (Bank of America, JPMorgan Chase, Wells Fargo, and Citigroup) dominates the financial industry in terms of total assets and revenues. Three of these largest banks are included in our sample as early adoption banks.[9] In order to examine whether our findings are driven by the significant difference in size between the early adopters and non-early adopters, we exclude the three biggest banks, i.e. Bank of America, JPMorgan Chase, and Wells Fargo, from our sample and repeat our analysis. The robustness test generates qualitatively similar results to our main test.

CONCLUSIONS AND IMPLICATIONS

This study is inspired by the controversy over fair value accounting standards during the last financial crisis. In response to the pressure to revise the accounting standards to alleviate the stress in the banking industry during the financial crisis, FASB issued the series of guidance to amend fair value accounting in April 2009. Subsequently, investor advocates expressed serious concerns about the quality and integrity of the new standards. FCAG, an advisory group for the IASB and FASB, noted that the independence of the boards may be compromised under the pressure of policy makers.

The early adoption of the fair value guidance by certain banks in the first quarter of 2009 allows us to make a timely study about the effects of the new accounting standards on financial

[9] Citigroup is classified as a financial services institution (SIC 6199) and is not in our sample.

reporting. Statistics from banks' disclosures demonstrate that the adoption of the new fair value guidance helped at least some of the early adoption banks to maintain favorable asset valuation and, more importantly, had substantial positive effects on most early adoption banks' earnings and core capital. Our regression analysis documents that the early adoption banks have more level 2 and level 3 assets than the non-early adopters. We also find evidence that banks' early adoption decisions were motivated by the incentives to boost their core capital reserves and to avoid reporting losses. The finding raises concerns that companies may be taking advantage of the accounting discretion in the fair value guidance for purposes that are not the intent of the new standards.

Our findings, although descriptive in nature, provide early evidence on the impact of the fair value guidance on banks' financial statements. The information should be useful for standard setters and regulators to assess the effects of the new guidance on financial reporting. This study also presents detailed statistics that can be applied by accounting educators in the classroom to inform students and be used by accounting researchers to inspire future research.

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EMPLOYERS AS INSURERS: A CASE FOR A STRATEGIC APPROACH TO EMPLOYEE HEALTHCARE

Steven D. Caldwell, University of South Carolina Upstate
Earle W. Lingle, South University School of Pharmacy

Abstract: With increasing health care costs and changing government regulations, businesses must decide their approach on employee healthcare benefits. While many companies have taken a "hands off" approach, some companies have chosen a strategy that controls the costs of health care and gains employment engagement with a culture that values good health. This study tracks the results over five years of a mid size business that decided being the health care insurer enhances the psychological contract with its employees so that direct costs of health care are below national trends and new employees share the company's values for good health.

The national debate on health care heated up significantly in 2009 as the costs of health care have significantly outpaced inflation, growing 2.4 times faster than GDP since 1970 (Kaiser Family Foundation, 2009). Major public policy was passed by Congress and signed into law by President Obama in spring 2010. This came after rising health care costs threatened the US economy, leaving millions of citizens without health insurance and vulnerable to the costs of meeting their health care needs.

Unfortunately, the national public policy approach is seen by many as simply insurance reform, shifting costs from one payer to another and making insurance available to the millions who currently do not have it for various reasons. While this seems helpful to some people in society, the criticism has been that it results in uncertainties for care and does not reduce the cost trends of health care. Unless the total costs of delivering health care services to the US society abate, the growth in overall lifestyle and well-being of individuals will be negatively affected. Recent research posits health as a significant component of a nation's economic strategy; "the survival of American businesses depends upon shifting medicine's singular focus of managing sickness to a much more encompassing view of managing health" (p. 9, Edington, 2009)

Historically, the traditional health insurance agents of US society are for profit insurance companies and nonprofit government programs, such as Medicare and Medicaid. The strategic objectives of these organizations are to remain economically viable by means of constraining utilization of medical care and reimbursement to providers. Thus, cost containment is not focused on lowering overall costs and has little consideration for the effects of the cost controls on the resulting health and well-being of individuals. Especially lost in this strategic approach is investment in preventive and wellness behaviors of individuals.

Another trend in US society has been that employers underwrite the premiums for the enrollment of their employees in for profit insurance programs. While no natural relationship exists between employment and health care, this linkage began midway through the last century as a strategy for employers to provide social exchange with employees beyond wages, which had at times become constrained by government regulation, such as wage controls. Over time, companies, as financiers of health care insurance, have created several cultural phenomena that have engendered the health care crisis. US businesses now operate in a global community and the economic burden of employee health care benefits makes US businesses less competitive, resulting in jobs moving abroad and businesses progressively abandoning

employees' health care benefits. A development working in opposition to reducing healthcare costs is employees' growing sense of entitlement regarding prepaid services associated with acquiring a "pill to fix" problems at no expense to them and a sense that poor health "just happens" requiring no behavioral change (Edington, 2009). Thus, incentives for organizational behavior and individual behavior are not aligned with actions necessary to bend the cost curve of health care downward.

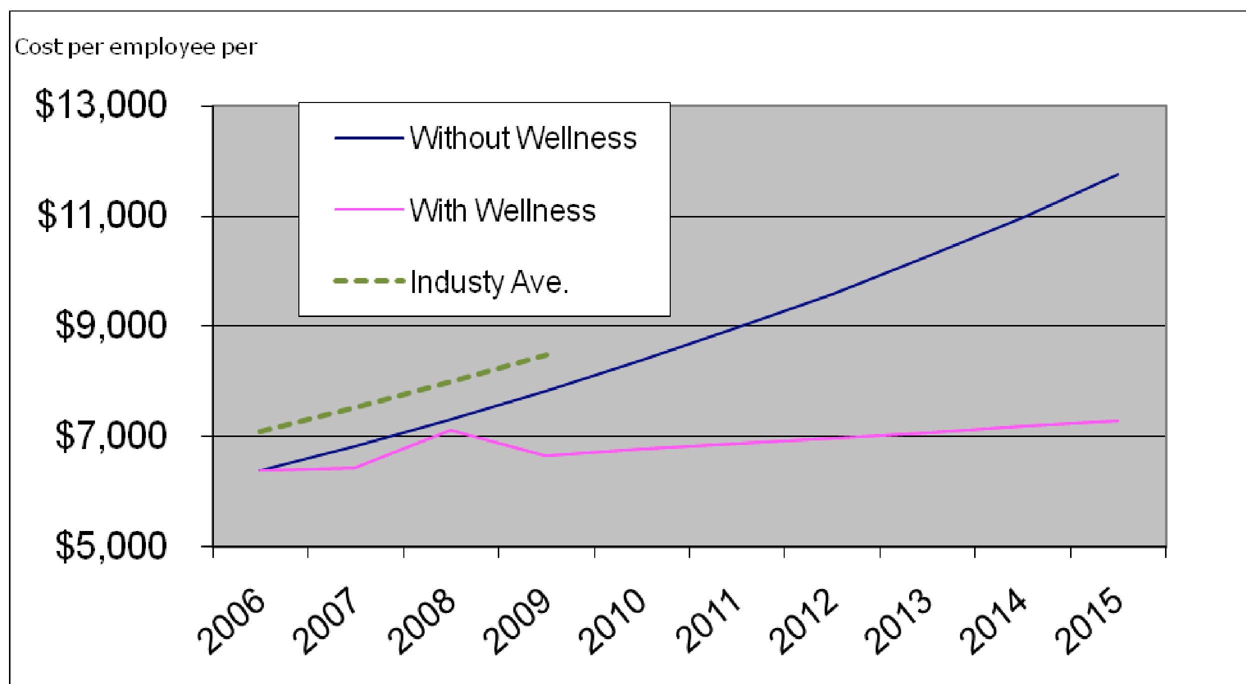
In response to this more than half of US businesses are offering wellness programs to lower costs (Kaiser Family Foundation, 2009). However, these programs lack much strategic focus. They are generally distal to employee motivation in that over 80% of these preventive measures are offered by the health plan and not directly by the company. To increase the effectiveness of such programs, some companies are more strategic by becoming the insurer. Because companies have a relationship with their employees (e. g., psychological contract), opportunities exist for behavioral influences to be more proximal to individuals. Thus, employers maintain the employment advantage of providing health care benefits to employees but are using their relationships with employees to realign incentives so that individual behavior is more likely to change in line with reducing overall health care costs (Baicker, Cutler, & Song, 2010). Because of economies of scale, this practice has been more attractive to larger organizations (more than 1000 employees) and not seen as a viable option for small to mid-size organizations. In addition, while research on these programs show economic value to the employer (Baicker et al., 2010) and quality of life improvements for employees (Keller, Lehman, & Milligan, 2009), questions still remain as to which attributes of wellness programs are most important, time paths for return on investment, factors that make the programs successful, and motivational barriers to wider adoption.

Thus, there are basically three options for organizations regarding employee healthcare. The traditional approach is to employ a third party insurance company to underwrite the risks and provide the products and services to cover the costs of employees' healthcare. This approach is utilitarian and limits the ability to influence individual preventive behavior. The main management decision usually focuses on what portion of the cost is paid by the employer and what part is paid by the employee. Given recent legislative actions regarding healthcare reform and employer mandates, employers may abdicate any involvement in healthcare by eliminating healthcare insurance and paying a fine which allows employees to get insurance on the open market. The third option is to become the insurer. This is a business strategy to leverage the power of employer-employee relationships, offering organizations the opportunity to be more involved in their employees' well-being, and participating proactively in society's challenge to reduce the healthcare costs of individuals (corporate social responsibility).

A case for the third option is addressed in this paper. Using actual experience from a field study conducted in a for profit business with approximately 1,000 employees, we demonstrate how one business has strategically engaged its employees to achieve greater compliance with professional advice on disease management, for better choices on medications, and for wellness behaviors aimed at staying healthy . Figure 1 shows the current and projected economic benefit to this employer who has found creative and productive ways to alter individual behavior so that overall healthcare related costs are significantly lower for employees who take advantage of the wellness programs.

Figure 1

Health care costs per employee (including family members) for J M Smith Corp. One comparison is employees in the Wellness Program versus those who are not (assuming costs continue at expected trends). The company's costs are also compared to the actual national average.



However, typical aggregate data results includes "noise", such as characteristics of the mix of employees coming in and out of the programs across time and inclusion costs of family member who are not directly affected by employer-employee relationships. This study goes beneath the surface of broad base reporting measures to explore potential behavioral patterns that explain how individuals themselves are responding to the business strategy for improving individual healthcare. Included in this paper are detailed discussions of the business strategy for behavioral change existing in the current health care stakeholder model, the program elements of the company being studied, results of an intra-person analysis of individual healthcare costs across time, and further directions for altering corporate strategy, which can decrease direct healthcare costs and increase employee engagement.

STAKEHOLDER MODEL

Stakeholders are any entities (person or institution) that are affected by decisions involved in individuals' health care. Some stakeholders, such as individuals and doctors, determine what activities occur in providing healthcare. Others, such as employers, insurers, and government, determine who pays the costs of the activities associated with individuals' healthcare. Prices paid for products and services are determined by doctors, hospitals, insurers, pharmaceutical companies, and government and are often constrained by the third-party payers. The boundaries of stakeholders can become blurred when employers and government become insurers.

> The main issue in reducing overall healthcare costs is that the incentives of each stakeholder are not aligned. That is, doctors and hospitals only get paid if individuals seek products and services and incur costs. Insurers make more profit if individuals need little or no healthcare products and services. The government is more motivated by social justice than efficiency of market forces and personal responsibility. Ultimately, the cost curve on healthcare can only be lowered when there are less products and services rendered and/or the prices of such products and services are reduced. Thus, changes in the stakeholder model are necessary because there are current systemic influences working against behaviors required to lower overall costs.

Historically, cultural trends have developed that result in influences on individuals and doctors concerning products and services rendered. Long term practices of providing health insurance as an employer's way to attract and retain employees has resulted in an entitlement mentality of individuals, which suggest to them that healthcare is prepaid (by someone else) and essentially "free" to employees. For example, one of the most traumatic moments for many employers is the annual announcement of increases in employee health insurance premiums. Government provided insurance for the retired (Medicare) and poor (Medicaid) have strengthened this entitlement paradigm. A culture of litigation, supported by government's interest in social justice, has increased costs of healthcare by both the prices doctors' charge due to their malpractice insurance costs and the liberal use of services rendered due to the risk of malpractice claims.

Studies show that until individuals are motivated to become or remain healthy and to seek products and services when needed, the key determinant in reducing overall societal healthcare costs is not favorably affected (Gurchiek, 2008). Secondarily, until the supply of doctors and hospitals grows appropriately with the demand and the risks of malpractice associated with ordering products and services are reduced, prices charged by healthcare providers will continue to grow. Since prices are constrained by third party payee institutions, the constraint on prices will likely diminish supply.

This paper is mainly concerned with altering the historical behavioral model of individuals so that the need for healthcare products and services are reduced and the choices individuals make when they are needed are more centered on personal accountability. This model must be a multi-faceted business strategy. Some of the elements are preventive to influence individual behaviors required to get or remain healthy so that products and services are not needed. Other elements involve compliance with professional advice for the chronically diseased that can improve decisions about when and what type services are needed. Contrary to some prevailing norms, taking pharmaceuticals correctly is more favorable to overall costs than trying to constrain their use. Therefore, pharmaceutical practices, such as use of generics, provide another strategic element to change individual choices affecting their healthcare costs without compromising quality of care.

J M SMITH CORPORATION'S WELLNESS STRATEGY

The J.M. Smith Corporation has implemented several programs in an effort to not only positively impact employees' health and quality of life and decrease their medical care costs, but to enhance the psychological contract with its employees. As a self-insured corporation, a decrease in employees' medical care costs was expected to directly result in increased profits. J.M. Smith developed a Wellness Program based on the following philosophy of partnering with its employees:

1. Partnering the company with its employees to improve health and economics for both;

2. Partnering healthier lifestyles with appropriate medications; and

3. Partnering with other organizations in the community to share experiences regarding the value of the programs.

While maintaining a consistent strategic focus, J.M. Smith's wellness program has evolved since its inception in 2004. The first program was introduced with the provision of flu shots for employees and on-line wellness education modules. For completion of the wellness modules, employees were awarded a $100 incentive. In 2005, generic drug co-pays were reduced to $3 per prescription, and the incentive for the completion of the wellness modules was increased to $150. In addition, employees were provided $50 for preventive care and the maximum reimbursement for such care increased to $400. In 2006, J.M. Smith began providing medical care directly to employees through on-site nurse practitioners. Nurse practitioners (NP's) screened employees for different health risks, counseled employees regarding needed lifestyle changes (e.g., diet and exercise) as well as provided regular follow-up care. In addition, NP's provided employees with on-site medical care support for common conditions such as colds and minor pain. Also, the corporation began providing employees with incentives through "workout bonuses" for their efforts to maintain or improve their fitness. Initially, the bonuses were in the amount of $75 but increased in 2008 to $100 per quarter. In 2007, disease management programs were offered to help employees predisposed to or diagnosed with diabetes or cardioarterial disease. This program expanded in 2008 to include employees with hypertension and hyperlipidemia. J.M. Smith's Wellness Program continued to evolve in 2008 with an expansion of financial incentives for employees to include pro health behaviors in their daily routine. For example, employees completing recommended preventive care tests were awarded decreases in their deductibles, and a fitness challenge program was introduced which provided additional financial incentives for weight loss. The various components of the program in effect in 2010 are discussed below.

Health Risk Assessment

J.M. Smith employees are provided a Health Risk Assessment (HRA) each year at no charge to them. The HRA consists of two components, an on-line questionnaire that results in a Personal Wellness Profile and a Biometric Screening. This screening is conducted by the on-site nurse practitioner and among the tests provided are: Complete Blood Count (CBC); TSH (thyroid screening); complete metabolic panel for patients taking medications for diabetes, elevated cholesterol levels, and other conditions; lipid panel; blood sugar; and PSA (prostate screening for males 40 years and older). Tests vary according to the age of the employee or dependent (see Appendix A). The HRA is required of employees and their dependents each year if they desire to participate in a J.M. Smith's medical care plan during the following year. In addition, J.M. Smith provides a financial incentive for employees by giving them a $200 decrease in their health insurance deductible if all the tests are completed by the end of the year. Findings of the HRA are confidential information with access to them limited to the employee and the nurse practitioner who is not a J.M. Smith employee.

On-site Nurse Practitioner

The nurse practitioner's primary focus is to use the results of the HRA to help identify employees with chronic medical conditions. Based on the HRA findings, the NP may

recommend the patient receive follow-up care and/or develop recommendations for employee lifestyle changes, e.g., diet and exercise. Secondarily, the NP provides medical care for common medical conditions or referrals to other health care professionals for further care.

Disease Management Program

J.M. Smith contracts with a third-party provider to review employees' medical claims for diagnosis and/or treatment of four chronic conditions: diabetes, cardioarterial diseases (CAD), hyperlipidemia, and hypertension. Employees who are found to have one of these conditions are offered the opportunity to participate in the Individualized Care Program. Participation in this program is voluntary and all information remains confidential between the employee, provider, and nurse practitioner. Recommended guidelines are developed for each participating employee and compliance goals are established based on the disease, its severity, and the employee's health condition. If the participant meets the compliance goals, he/she receives medications and supplies used in treating the condition at no charge to them.

Incentive Programs

Workout Bonus: To promote exercise, J.M. Smith provides a $100 quarterly bonus intended to reimburse employees for gym/health club membership. To receive the bonus, employees and spouses covered under a J.M. Smith medical insurance plan provide verification from the health club that they used the facility at least twelve times during the previous quarter.

Weight Loss Challenge: For employees that need to lose weight, the nurse practitioner will set a weight loss goal for the employee to achieve over a six-month period. If the employee meets that goal, he/she will be provided a $500 bonus. If an employee maintains or goes under the weight goal over the next two years, J.M. Smith will award them another $3000 bonus.

Walk across America: J.M. Smith participates in the Walk across America program. Employees who participate in this program are awarded gift cards for their involvement.

In summary J.M. Smith's current Wellness Program consists of a variety of components. Some of these are mandatory while others require choices by individual employees. Some of these components provide direct medical care by a health professional whereas others promote self-care. Although based on the programs introduced since 2004, the Wellness Program has been modified as the corporation learned about the needs of employees and the company. The company continues to find ways to improve the programs by increasing motivation of employees to participate. For example, the goal is to increase percent compliance in the DM program from the current level of 72% to 80% by using one company location, which is at 100% compliance, as a challenge to employees in other company locations. By 2009 the total annual fixed costs of providing onsite Nurse Practitioners, physician counsel, DM, HRA, etc. was $415 per employee. All other direct variable costs and trends associated with the program elements are included in the following analyses.

ANALYSES AND RESULTS

When determining the benefit of employer wellness programs, there are a number of considerations associated with the analyses. Often analyses of economic benefits of wellness programs involve total annual changes in costs for employee populations where employees are categorized each year as to participation level (Figure 1). Since employees come and go across time, the year to year comparisons involve different employee mixes with variances in health

conditions that are unaccounted for in the analyses. Because the number of employees changes from year to year, costs per employee are generally used as the evaluative metric, yet the number of employees is a moment in time metric (usually end of year) and costs are incurred across the twelve months involving a different employee count throughout the year. Health care costs are subject to "spurious outliers" which can easily distort use of means as a tracking metric unless the study population is quite large. Costs can be defined in a number of ways, such as (1) total costs of employee and family, (2) just employee or company costs, or (3) total of company plus employee costs.

To address these issues the analyses in this study involved intra-employee healthcare costs, including all costs incurred by an employee regardless of who paid. Family members who would not be affected by the wellness programs were excluded. Thus, we hold the employee population constant for five years (476 individuals) providing two pre-program years and three years in which employees chose to participate or not in the programs offered by the employer. In addition, several qualifiers, such as demographics, were used to determine if such factors may contribute to results and as an attempt to isolate spurious claims. Since average healthcare costs can easily be affected by a few, high cost claims, the reduction of risks, represented by reducing the variation of individual claim costs, would be a favorable outcome of preventive wellness programs.

Initial results show that healthcare costs for all 476 employees were basically flat for the five years at approximately $4000 per employee (Table 1). However, when we segregate individuals as to whether they qualify for the Disease Management (DM) Program (129 employees with one or more of four chronic diseases) and whether they were in compliance by the end of 2009 (91 of the 129), we find that both the average costs of these individuals are higher than the total population and the trend is better for those who were in compliance at end of 2009 with the requirements of the program versus all DM employees (including those who did not comply). Table 2 shows for the three years of the program (2007 – 2009) while absolute levels of costs for long term employees in DM in compliance were much higher than employees without chronic disease, they were only two thirds (67%) of the costs of those who were not in compliance (38 employees). This compliance gap for employees in DM is much smaller for employees who were employed more recently (92%). This may suggest that there is a lead time for newcomers with chronic disease to be evaluated, have an Individualized Care Program developed, and become motivated to comply. Further, while longer term employees who have not been diagnosed with a chronic disease have much lower absolute average costs, their trend is rising. There may be several reasons for this: 1) it is more difficult to impact healthcare costs for relatively healthy individuals in the early years of a preventive program; 2) there are still some chronic disease conditions that should be brought into DM; or 3) reducing total chronic disease costs is somewhat offset by investing in preventive care activities for the healthy employees with lower costs. This question is worth further investigation.

Table 1
All employees hired before 2004 and still employed in 2010
(average individual healthcare $ costs for the year)

	#employees	2005	2006	2007	2008	2009
All employees	476	3655	4028	3549	3424	4088
DM	129	8572	7188	5186	4731	5171
DM compliance	91	10386	7848	4564	4022	4653
Not DM	347	1827	2853	2940	2938	3685
Male: DM compliance	52	15276	11660	4486	4454	3090
Female: DM compliance	39	3865	2765	4669	3445	6736
Male not DM	196	1590	3162	2733	2516	2866
Female not DM	151	2134	2452	3208	3485	4748
< 45 (DM compliance)	18	1861	964	3182	5611	830
> 45 & < 60 (DM compliance)	39	2786	3479	3860	3193	8239
> 60 (DM compliance)	34	23616	16503	6105	4131	2563
< 45 (not DM)	177	1833	2838	3052	2707	3052
> 45 & < 60 (not DM)	140	1704	2648	2641	3267	3924
> 60 (not DM)	30	2361	3896	3674	2761	6303

DM: employees placed in the Disease Management program
DM compliance: employees in the DM program who were in compliance with program requirements at end of 2009
Not DM: employees who did not need to be in the DM program

Table 2

All employees hired before 2004 and still employed in 2010 (476 employees)

Year	Maximum	Std Dev	Mean	Median	Skewness
2005	$603,417	$28,162	$3655	$399	20.5
2006	$365.697	$20,628	$4028	$422	13.6
2007	$165,259	$11,053	$3549	$524	8.4
2008	$150,150	$10,490	$3424	$558	8.6
2009	$103,530	$11,751	$4088	$618	5.5

All employees hired between 2004 and 2006 and still employed in 2010 (312 employees)

Year	Maximum	Std Dev	Mean	Median	Skewness
2007	$91,173	$8544	$3464	$521	5.2
2008	$81,307	$7273	$3127	$597	5.7
2009	$55,409	$7878	$3628	$628	3.7

Including employee demographics in the analyses (Table 1), we see that the overall trends and levels of cost are very different for males and females. The trends for males are favorable and unfavorable for females, regardless of whether they are in DM or not. The absolute levels of costs are also considerably lower by 2009 for males than females. When we view the costs by age (also Table 1), we see the significant downward trend of costs for those with chronic disease in compliance with professional advice is primarily driven by employees over 60 years old. However, all other age categories do not show a declining cost trend and the 2009 absolute cost level problems are generally with mid-age chronic disease employees in compliance and individuals over 60 years who are not associated with a chronic disease.

To evaluate the effects of wellness programs on new employees we analyzed the difference in recent costs (2007 – 2009) for employees hired after 2004 and were still employed in 2009 (312 employees). Results (Table 2) show that those who were hired after the initial implementation of the wellness programs show overall lower costs than those whose employment was established prior to the change, particularly those who are not in DM program (Table 3). This may result from hiring practices influenced by a culture of wellness, which attracts new employees who value wellness. When we look further at recent hires with chronic disease, we see a more significant recent (2009) impact of compliance (Figure 2). The pattern and level of costs for recent hires in compliance is different for employees with chronic disease who have been employed longer and are in compliance with the program. However, the costs are similar for short and long term tenured employees by the third year. Further, the percentage of employees in DM and in compliance is significantly higher for the newer employees hired with the program already initiated (81%) than the ones who went through the change to the program (71%). The motivation to comply seems to be stronger when employees are hired with the wellness culture in place than the employees who joined the company without such culture and experienced the cultural change.

Table 3

Per employee per year means of costs for the last three years of the Wellness Program

Employee category	# employees	Mean
Employees hired before 2004:		
Not in Disease Mgt	347	$3187
Disease Mgt in compliance	91	$4413
Disease Mgt not compliance	38	$6505
Employees hired between 2004 and 2006:		
Not in Disease Mgt	237	$2789
Disease Mgt in compliance	61	$5271
Disease Mgt not compliance	14	$5737

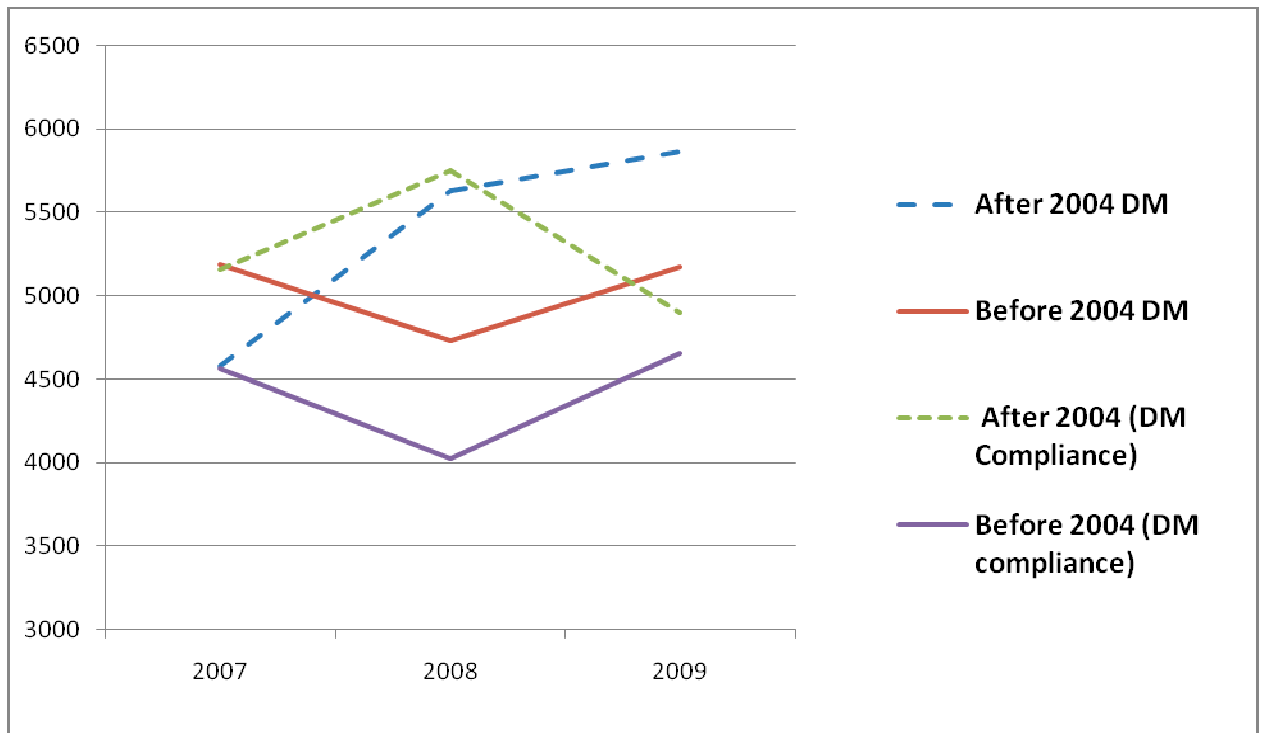
Figure 2

Healthcare costs for employees hired before and during implementation of Disease Management program

number of employees:

75 (hired after in DM), 129 (hired before in DM)

61 (hired after 2004 DM compliance), 91 (hired before 2004 DM compliance)



We mentioned that healthcare costs can be affected by a few spurious high cost claims. We see this effect in Table 2 where the mean is generally 8 to 10 times the median. Interestingly, the experience of a few individuals affecting the mean decreases across time as the maximum individual cost and the standard deviation consistently decrease after the Wellness Program is implemented. The skewness statistic measures the symmetry of a distribution (a normal distribution has a skewness of 0). The reduction in the skewness statistic may suggest the risks of spurious claims events are much less after the wellness initiatives were implemented. Further, the measures of variability are even less for employees who are hired when the culture of healthcare has already been affected by the Wellness Program.

One of the strategies of wellness initiatives is for the employer to invest in preventive activities and to emphasize the correct use of medications (see the above section on the Wellness Program). Increasing preventive costs to mitigate the occurrence of spurious high end claims involves each employee doing more low cost preventive activities, which results in the slight increase in median employee costs across time (seen in Table 2). This trend in median costs is corroborated by the growing investment by the employer in preventive wellness activities (Table 4). The proper use of medications to prevent chronic illness events generally results in individuals taking more, not less, medications. By providing generic prescriptions at little or no costs to the employee, the employer can invest a small amount in pharmaceuticals to reduce the risks of chronic illness claims. It is expected that the increase in both the employer's prescription costs and the increase in the percent of prescriptions that are generic suggest that this strategy may be one of the contributors to the healthcare cost trends for J M Smith being below industry averages.

Table 4

Costs are the company's per employee per month and include all employees regardless of hire date along with their family members covered

	Employer's preventive care investment	Rx claims	% of Rx generics
2005	$13.66	$75.25	48%
2006	$14.39	$74.88	57%
2007	$22.76	$94.87	64%
2008	$38.16	$106.90	69%
2009	$33.46	$112.73	71%

CONCLUSIONS AND FUTURE DIRECTIONS

The business strategy for JM Smith Corporation is to engage its employees with personal responsibility for their own healthcare. Various incentives are used to directly motivate employees towards preventive and healthy behaviors, but developing a culture of wellness seems to attract new employees who fit with the wellness values of the company. While it is difficult to see immediate overall reductions in employee healthcare costs, the relatively flat trend is more favorable than the rapidly rising costs in society as a whole and the reduction in variability of individual costs suggest the program reduces risks of high cost events. In order to better understand the effects of a wellness program, the same employees were tracked across time and evaluated by various categories to see what factors may be working well and those that may not be.

Considerable attention is given to identifying and managing the care of those who have more chronic health conditions. Results support the notion that employees with certain chronic conditions will incur greater costs, but if they are identified and comply with professional advice on their care, their costs will be lower than those who do not. Results also indicate a culture of wellness can attract wellness oriented individuals who will be more likely to respond to the DM professional advice for taking their medications. The segmentation of employees by gender and age provide some insight into future opportunities. For instance, the most dramatic positive impact on costs occurs with older men who ultimately comply with professional care. This supports the speculation that males are generally less likely to take preventive medications. Also, the female trends may suggest that the DM program does not include the chronic diseases that pertain to females relative to males. Along with the age trends, the DM program may need to identify additional health issues associated with mid-age females that could benefit from professional preventive care. The age trend also suggests that employees over 60 should be in a professional care program similar to DM regardless of the health assessment measures.

This study contrasts employees who went through the organizational change from more traditional healthcare programs to the one existing today that emphasizes prevention and wellness. It appears that gaining participation and results for employees who change to a new wellness program may be more challenging than for those who join the organization after attention to wellness programs are already present. This suggests that organizational change practices that engender cultural change in existing employees may require more attention than employers may anticipate. Employers need to approach the implementation of a Wellness Program not just as a benefits change, but a change in norms and values of the organization (Edington, 2009) that make the notion of wellness more salient to employees who have been

with the company for some time. This is particularly important since the age and tenure of employees correlate positively (r = .34) and the older employees are the higher costs employees (r = .12).

Since the success of a Wellness program requires individual employees to change their behavior so that they include more preventive activities in their lives, most programs, including the one at J M Smith Corporation, tend to use financial incentives to affect changed behavior. While economics can be motivating to some employees, monetary rewards have limited effects on behavioral change because the amount may not be salient to some individuals and/or money does not have the same valence to all individuals. Employee surveys show “for lasting health improvement, wellness programs must coach and inspire workers to take responsibility for their lifestyle choices and give them the tools to self-manage their health.” (Gurchiek, 2008).

Therefore, organizations should look to proven organizational dynamics to affect employees’ intrinsic motivation for preventive healthcare behaviors. One such field of study is change leadership. Transformational leadership (Bass & Riggio, 2006) is well established as the means by which organizations can inspire employees to “unfreeze” (Lewin, 1951) or change their behavior away from status quo. The challenge is to see the implementation of a Wellness Program not as just a Human Resource benefit change, but as a valued and expected behavior of all employees as a strategic element of winning in the competitive market place.

Another relevant field of study involves the recent trends of practitioners and scholars to extend the notion of employee performance beyond in-role behavior (e.g., job performance) to extra-role behavior (e.g., helping others; see Turnipseed, 2005). It may be productive for organizations to consider preventive wellness behaviors as a form of extra-role behavior. This would allow management to utilize the body of knowledge on contextual behavior to inform them on the individual employee’s wellness behaviors that would reduce healthcare costs and increase organizational performance as a result of greater employee engagement.

In conclusion, why would being a healthcare insurer be a good business strategy? As mentioned earlier, there are basically three options for management to take: (1) the traditional utilitarian approach to employ a third-party insurance company to underwrite the risks and provide the products and services that cover the costs of employees’ healthcare; (2) the abdication approach to eliminate healthcare insurance, pay a fine (under healthcare reform) and allow employees to get insurance on the open market; or (3) the strategic approach to become the insurer utilizing the power of relationships to influence employee well-being.. The strategic approach addresses both corporate social responsibility as well as enhancing organizational success through employee engagement, which includes employee fit with the organization and extra-role behaviors associated with personal wellness of employees.

Appendix A

Preventive Measures Program: Recommended tests for employees and covered dependents

	Age 19-39	Age 40-49	Age 50+
Routine Checkup	Every year	every year	every year
CBC (Complete Blood Count)	Every year	every year	every year
TSH (Thyroid)	every year	every year	every year
Complete Metabolic Panel IF currently taking medications for diabetes, cholesterol control, etc	every year	every year	every year
Lipid Panel	every year	every year	every year
Blood Sugar	every year	every year	every year
PSA (Males)	every year	every year	every year
Pap Smear (Females)		every year	every year
Mammogram (Females)		every year	every year
DRE (Digital Rectal Exam)		every year	every year
Fecal Occult Blood Test			every year
Colonoscopy			Baseline established at age 50; then every 5 yrs if you are age 51 or older during 2009 you must have had a colonoscopy in 2009 to establish your baseline, then ever 5 years.
Vision (Optional)			
Hearing (Optional)			

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A COMPARISON OF RETIREMENT PLAN BENEFITS IN HIGHER EDUCATION: STATES PARTICIPATING IN SOCIAL SECURITY VERSUS NONPARTICIPATING STATES

Shari Lawrence, Nicholls State University
John Lajaunie, Nicholls State University
Norbert Michel, Nicholls State University
Shawn Mauldin, Nicholls State University

Abstract: The purpose of this paper is to compare the individual retirement benefits of a faculty member employed by a public university that participates in the Social Security System, to the benefits of a faculty member at a university that does not participate in Social Security System. The present value of the Social Security benefit an individual would receive over a 20 year retirement period if he or she were employed in a participating state is estimated and compared to the retirement benefits in a nonparticipating state under several different scenarios. The analysis of these scenarios indicates that employees in the typical nonparticipating states can expect to be approximately $200,000 worse off at retirement than employees in participating states based on a scenario without any supplemental tax-deferred plans. In order to obtain the same total retirement benefits, employees in nonparticipating states need to contribute an additional 2.58% of their salary to a supplemental tax-deferred retirement plan throughout their working career.

INTRODUCTION

When considering employment in higher education, it is important for the potential faculty member to consider factors such as salary, promotion opportunities, and of course, medical and retirement benefits. While previous research has focused on comparing the types of retirement plans available at public universities (Michel, et al., 2010; Lahey, et al., 2008), to the authors' knowledge, there has not been any research conducted on the issue of Social Security participation at these institutions. At the present time, public employees in seven states (Alaska, Colorado, Illinois, Louisiana, Massachusetts, Nevada, and Ohio) do not participate in the Social Security System. Therefore, one must look closely at the retirement plans in these states compared to those states where employees are participating in the Social Security System. For instance, potential employees should not take for granted that the nonparticipating states will have higher contribution rates, thus leaving retirees (at the two different types of universities, participating and nonparticipating) in the same financial position.

Although many states offer two types of retirement plans: defined benefit (DB), and defined contribution (DC), the focus of this paper is on DC plans.[10] The motivation is that DC plans are becoming increasingly popular among new faculty due to the portability feature as well as the ability to control the investment dollars. In addition, the current budget crisis affecting many states makes the future of DB plans uncertain.[11] The purpose of this paper is to compare

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[10] Under a DB plan, participants are paid a guaranteed pension based on an actuarial formula that includes the average salary for the last few years employed, years of service, and a fixed percentage. With DC plan, the retirement benefit is simply the participant's total account balance at retirement, and consists of employer contributions, employee contributions, and investment earnings.

[11] Since the onset of the financial crisis, some states (Michigan and Alaska for example) have abandoned their DB plan options for new employees (Behunek, 2010).

the individual retirement benefits of a faculty member employed by a public university that participates in the Social Security System, to the benefits of a faculty member at a university that does not participate in Social Security System. The present value of the Social Security benefit an individual would receive over a 20 year retirement period if he or she were employed in a participating state is estimated and compared to the retirement benefits in a nonparticipating state under several different scenarios. The analysis of these scenarios indicates that employees in the typical nonparticipating states can expect to be approximately $200,000 worse off at retirement than employees in participating states based on a scenario without any supplemental tax-deferred plans. In order to obtain the same total retirement benefits, employees in nonparticipating states need to contribute an additional 2.58% of their salary to a supplemental tax-deferred retirement plan throughout their working career.

The calculations are based on the assumption that the faculty member would have worked at a public university for 30 years, and retired at the end of 2009 with an annual salary at retirement of $105,000. This salary is the median level for the combined faculty category for new hire assistant professors for all public universities accredited by AACSB International for the 2008-2009 academic year. Further, it is assumed that the individual received a 2% cost of living increase each year they were employed. Note that the current employee portion of the Old Age, Survivor and Disability Insurance (OASDI), commonly referred to as the Social Security tax, is 6.2%. The total OASDI tax is 12.4% (6.2% from the employer and 6.2% from the employee up to a wage limit in 2010 of $106,800). The online benefit calculator available at the Social Security website was used to determine the applicable Social Security benefit.[12] The rate of return used to estimate the future value of a faculty member's DC plan is 8.42%. This return is the average of the geometric mean rates of return for the S&P 500 and the Dow Jones Industrial Average (DIJA) from 1980 to 2009.

Comparing Contribution Rates

As a starting point, the average required employee and employer contribution rates into the defined contribution (DC) plans (also referred to as optional retirement plans (ORP)) for employees of both types of universities are presented. Table 1 summarizes the mean contribution rates into DC plans for participating and nonparticipating Social Security states.

Table 1 - Contribution Rates for Universities in States That Participate in Social Security vs. Those That Do Not

	Mean Employer Contribution	Mean Employee Contribution	Total Contribution
Non SS Participating	8.18	8.08	16.26
SS Participating	8.21	4.46	12.67

The statistics in Table 1 are taken from Lawrence, Lajaunie, and Mauldin (2010).

The figures in Table 1 show that there is no significant difference in the employer contribution rates between participating and nonparticipating universities. This fact amounts to an effective employer cost savings of 6.2% per employee (the amount equal to the employer portion of

[12] http://www.ssa.gov/estimator.

OASDI) for nonparticipating states. In other words, non-participating states are contributing the same amount to the faculty member's retirement as participating states, but participating states are also paying into the Social Security System on behalf of the employee.

There is a significant difference, however, in the required employee contribution rates for universities in states participating in Social Security compared to those that do not participate. Specifically, the mean employee contribution rate for nonparticipating states is 8.08% compared to 4.46% for participating states. This difference seems logical in that the required employee contribution should be higher in nonparticipating states since those employees are not subject to the 6.2% OADSI deduction. Clearly, nonparticipating states have shifted the burden of making up for this lack of Social Security benefits to the employee.

Finally, the mean total retirement plan contribution in states not participating in Social Security is 16.26% compared to a 12.67% contribution in states participating in Social Security. The mean contribution rates illustrated in Table 1 will be used as a basis for our analysis in the subsequent sections of the paper.

Social Security Benefits and DC Benefits

The potential retiree's Social Security benefits were estimated using the online benefits calculator available at the Social Security website.[13] It is assumed that the faculty member began working at a public university in 1980, in a state that participates in the Social Security System. It is also assumed that the faculty member was born in December of 1943 and will retire in December of 2009, at age 66, after a 30 year career. Note that the retirement age of 66 is significant because this is the full or normal retirement age, as defined by the Social Security Administration, at which an individual born in 1943 can begin receiving full Social Security benefits.[14] From age 62 to 66, SS benefits would be reduced. In addition, from age 66 and two months to age 70, benefits would be increased.[15] It is further assumed that the faculty member's salary at retirement is $105,000: the median level for the combined faculty category for new hire assistant professors for all public universities accredited by AACSB International for the 2008-2009 academic year. Finally, it is assumed that the faculty member received a 2% cost of living adjustment each year of his or her career. Therefore, the $105,000 is discounted by a factor of 2% per year going back to 1980, as illustrated in Table 2.

Table 2 - Faculty Salary Throughout Career

Year:	1980	1981	1982	. . .	2007	2008	2009
Salary:	$59,127	$60,309	$61,516	. . .	$100,923	$102,941	$105,000

Based on the assumptions described above, the monthly Social Security benefit is $2,178. As illustrated in Table 3, this monthly benefit was annualized and increased by 2% per year for cost of living adjustments during retirement. It is assumed that the retiree will collect Social Security for 20 years, until December 2029, just prior to his or her 86th birthday. Finally, the present value (PV) of the Social Security cash flow stream is calculated using a 2% discount

[13] http://www.ssa.gov/retire2/AnypiaApplet.html

[14] The full retirement age is 66 years for individuals born between 1943 and 1954. There is a sliding scale for individuals born between 1950 and 1955. For anyone born in 1960 or later, the normal retirement age is 67 years. For a more detailed discussion, refer to http://www.ssa.gov.

[15] For the specific amounts of the SS reductions and increases, the reader may refer to the Social Security website: http:www.ssa.gov.

rate. The PV of the Social Security benefit is $512,470.59. This number will be used to compare the total retirement balances of employees in participating and nonparticipating states. To estimate DC retirement benefits, the future value of the individual's retirement is calculated using our standard salary assumptions (ending salary of $105,000 in 2009 obtained through 2% annual raises over 30 years). Using the average of the geometric mean returns for the S&P 500 and the DJIA from 1980 to 2009 as the rate of return, future DC benefits were estimated (see Table 4 below).

Table 3 - Estimated Annual Social Security Benefits During Retirement

Year	Annual SS Benefit
1	$26,136.00
2	$26,658.72
3	$27,191.89
4	$27,735.73
5	$28,290.45
6	$28,856.26
7	$29,433.38
8	$30,022.05
9	$30,622.49
10	$31,234.94
11	$31,859.64
12	$32,496.83
13	$33,146.77
14	$33,809.70
15	$34,485.90
16	$35,175.61
17	$35,879.13
18	$36,596.71
19	$37,328.64
20	$38,075.22
	PV@2%
	$512,470.59

Table 4 - DJIA and S&P 500 Returns

Year	DIJA	S&P 500
2009	18.82%	23.45%
2008	-33.84%	-38.49%
2007	6.44%	3.53%
2006	16.28%	13.62%
2005	-0.60%	2.97%
2004	3.15%	8.99%
2003	25.32%	26.36%
2002	-16.76%	-23.35%
2001	-7.10%	-13.03%
2000	-6.17%	-10.14%
1999	25.23%	19.53%
1998	16.10%	26.70%
1997	22.64%	30.90%
1996	26.01%	20.29%
1995	33.46%	34.21%
1994	2.13%	-1.50%
1993	13.72%	6.88%
1992	4.17%	4.56%
1991	20.31%	26.36%
1990	-4.32%	-6.52%
1989	26.93%	26.98%
1988	11.86%	12.55%
1987	2.27%	2.06%
1986	22.56%	14.69%
1985	27.64%	26.35%
1984	-3.73%	1.21%
1983	20.06%	17.02%
1982	19.66%	14.63%
1981	-9.23%	-9.56%
1980	14.90%	25.93%
30 Year Geometric Mean Return	8.76%	8.09%
Average of the DJIA and S&P 500 Geometric Mean Returns: 8.42%		

Scenario 1: Retirement Benefits in Social Security Participating States

In Scenario 1, the total retirement benefit for an individual working at a university in a state that contributes to the Social Security System is calculated. Further, it is assumed that the employer contributes to the DC plan as illustrated in Table 1, whereby the mean combined employer and employee contribution rate in participating states is 12.67%. The future value of the individual's DC account is estimated using our standard salary assumptions (ending salary of $105,000 in 2009 obtained through 2% annual raises over 30 years). The rate of return used in the future value calculation is 8.42% (see Table 4).

The total retirement benefit for a faculty member employed at a university in a participating state is illustrated in Table 5. The total value of the retirement benefit is $1,620,298.52 and is comprised of two components. The first component is the value of the individual's university DC account balance upon retirement ($1,107,827.93). The second component is the present value of the individual's Social Security benefit ($512,470.59).

Table 5 - Retirement Benefits in Social Security Participating States

Year	Salary	SS Participating Contribution (12.67%)	FV@8.42%
2009	$105,000.00	$13,303.50	$13,303.50
2008	$102,941.18	$13,042.65	$14,140.84
2007	$100,922.72	$12,786.91	$15,030.88
2006	$98,943.85	$12,536.19	$15,976.94
2005	$97,003.77	$12,290.38	$16,982.55
2004	$95,101.74	$12,049.39	$18,051.45
2003	$93,237.00	$11,813.13	$19,187.63
2002	$91,408.82	$11,581.50	$20,395.32
2001	$89,616.49	$11,354.41	$21,679.03
2000	$87,859.30	$11,131.77	$23,043.53
1998	$86,136.57	$10,913.50	$24,493.92
1998	$84,447.62	$10,699.51	$26,035.59
1997	$82,791.78	$10,489.72	$27,674.30
1996	$81,168.42	$10,284.04	$29,416.16
1995	$79,576.88	$10,082.39	$31,267.64
1994	$78,016.55	$9,884.70	$33,235.67
1993	$76,486.81	$9,690.88	$35,327.56
1992	$74,987.07	$9,500.86	$37,551.12
1991	$73,516.73	$9,314.57	$39,914.63
1990	$72,075.23	$9,131.93	$42,426.90
1989	$70,661.99	$8,952.87	$45,097.30
1988	$69,276.46	$8,777.33	$47,935.78

1987	$67,918.10	$8,605.22	$50,952.91
1986	$66,586.37	$8,436.49	$54,159.95
1985	$65,280.76	$8,271.07	$57,568.84
1984	$64,000.74	$8,108.89	$61,192.29
1983	$62,745.82	$7,949.90	$65,043.80
1982	$61,515.51	$7,794.02	$69,137.74
1981	$60,309.33	$7,641.19	$73,489.35
1980	$59,126.79	$7,491.36	$78,114.85
		FV@8.42%	$1,107,827.93
		PV of SS Benefit @2%	
		over 20 yrs	$512,470.59
		Total benefit upon retirement	$1,620,298.52

Scenario 2: Retirement Benefits in States not Participating in Social Security

Under this scenario, the employment assumptions are the same as in the previous scenario except the faculty member is assumed to be employed at a university in a state that does not contribute to the Social Security System. Therefore, it is assumed that the individual will not be eligible for Social Security benefits based upon not having the required forty quarters needed to qualify.

It should be noted here that married individuals who are not eligible to receive Social Security based on their own work history are eligible to receive one half of their spouse's benefit. However, government employees are subject to the Government Pension Offset (GPO) which reduces the individual's monthly Social Security spousal benefit by two-thirds of his or her monthly government retirement benefit. Under our example, the amount of the individual's monthly retirement benefit results in a zero spousal Social Security benefit due to the GPO provision.[16]

As illustrated in Table 1, the mean total contribution rate for faculty members employed in states not participating in Social Security is 16.26% (8.18% from the employer and 8.08% from the employee). Therefore, with the contributions earning the 8.42% annual average rate of return, the future value of the individual's account upon retirement is expected to be $1,421,727.09 (see Table 6). The individual's university retirement plan account balance is greater under this scenario compared to the previous scenario because the overall contribution rate is higher (16.26% compared to 12.67%). However, the total retirement benefit is less due to the lack of Social Security benefits. Indeed, this individual has a shortfall of nearly $200,000 when compared to the employee in the participating state.

[16] For a more detailed discussion of the GPO and a zero Social Security benefit example, see Lawrence et al., 2009, pg. 24.

Table 6 – Retirement Benefits in Nonparticipating Social Security States

Year	Salary	Non SS Participating Contribution (16.26%)	FV@8.42%
2009	$105,000.00	$17,073.00	$17,073.00
2008	$102,941.18	$16,738.24	$18,147.59
2007	$100,922.72	$16,410.03	$19,289.83
2006	$98,943.85	$16,088.27	$20,503.95
2005	$97,003.77	$15,772.81	$21,794.49
2004	$95,101.74	$15,463.54	$23,166.26
2003	$93,237.00	$15,160.34	$24,624.38
2002	$91,408.82	$14,863.07	$26,174.26
2001	$89,616.49	$14,571.64	$27,821.70
2000	$87,859.30	$14,285.92	$29,572.83
1998	$86,136.57	$14,005.81	$31,434.18
1998	$84,447.62	$13,731.18	$33,412.69
1997	$82,791.78	$13,461.94	$35,515.72
1996	$81,168.42	$13,197.98	$37,751.12
1995	$79,576.88	$12,939.20	$40,127.22
1994	$78,016.55	$12,685.49	$42,652.87
1993	$76,486.81	$12,436.76	$45,337.50
1992	$74,987.07	$12,192.90	$48,191.09
1991	$73,516.73	$11,953.82	$51,224.30
1990	$72,075.23	$11,719.43	$54,448.41
1989	$70,661.99	$11,489.64	$57,875.46
1988	$69,276.46	$11,264.35	$61,518.21
1987	$67,918.10	$11,043.48	$65,390.24
1986	$66,586.37	$10,826.94	$69,505.98
1985	$65,280.76	$10,614.65	$73,880.77
1984	$64,000.74	$10,406.52	$78,530.91
1983	$62,745.82	$10,202.47	$83,473.74
1982	$61,515.51	$10,002.42	$88,727.67
1981	$60,309.33	$9,806.30	$94,312.30
1980	$59,126.79	$9,614.02	$100,248.42
		NFV@8.42%	$1,421,727.09

		No SS Benefits	$ - 0 -
		Total benefit upon retirement	$1,421,727.09

Scenario 3: Retirement Benefits in States not Participating in Social Security and an Additional 6.20% Contribution to a Supplemental Plan

In Scenarios 3 and 4, the effect of investing additional funds in a supplemental tax-deferred plan by faculty in a nonparticipating state is analyzed. Under Scenario 3 and 4, it is assumed that the faculty member who works in a nonparticipating state regarding Social Security is allowed to contribute to a supplemental plan. Supplemental plans, commonly referred to as 403(b) or 457 plans, allow faculty the opportunity to set aside additional tax deferred dollars. Hence, one has the opportunity to accumulate additional retirement funds using these various employer sponsored investment vehicles. In scenario 3, the individual contributes 6.2% of his or her annual salary to a supplemental plan (the amount equal to the OASDI employee withholding). The salary and rate of return assumptions are the same as in the previous scenarios. The results are illustrated in Table 7 (below). The 6.2% contribution to the supplemental plan amounts to $542,109.96 in additional benefits upon retirement. When this sum is added to the regular retirement plan account balance of $1,421,727.09, the total retirement benefit under this scenario is $1,963,837.05. This is an increase of $542,109.96 in total retirement benefits compared to Scenario 2 where no contributions are made to a supplemental plan, and an increase of $343,538.53 compared to Scenario 1 where the faculty member is participating in Social Security.

Table 7 – Retirement Benefits in Nonparticipating Social Security States with 6.2% to Supplemental

Year	Salary	Nonparticipating and 6.2% to Supplemental Acct.	FV@8.42%
2009	$105,000.00	$6,510.00	$6,510.00
2008	$102,941.18	$6,382.35	$6,919.75
2007	$100,922.72	$6,257.21	$7,355.28
2006	$98,943.85	$6,134.52	$7,818.23
2005	$97,003.77	$6,014.23	$8,310.32
2004	$95,101.74	$5,896.31	$8,833.38
2003	$93,237.00	$5,780.69	$9,389.37
2002	$91,408.82	$5,667.35	$9,980.35
2001	$89,616.49	$5,556.22	$10,608.52
2000	$87,859.30	$5,447.28	$11,276.23
1998	$86,136.57	$5,340.47	$11,985.97
1998	$84,447.62	$5,235.75	$12,740.38
1997	$82,791.78	$5,133.09	$13,542.28
1996	$81,168.42	$5,032.44	$14,394.65
1995	$79,576.88	$4,933.77	$15,300.66

1994	$78,016.55	$4,837.03	$16,263.70
1993	$76,486.81	$4,742.18	$17,287.36
1992	$74,987.07	$4,649.20	$18,375.45
1991	$73,516.73	$4,558.04	$19,532.02
1990	$72,075.23	$4,468.66	$20,761.39
1989	$70,661.99	$4,381.04	$22,068.13
1988	$69,276.46	$4,295.14	$23,457.13
1987	$67,918.10	$4,210.92	$24,933.55
1986	$66,586.37	$4,128.36	$26,502.89
1985	$65,280.76	$4,047.41	$28,171.02
1984	$64,000.74	$3,968.05	$29,944.13
1983	$62,745.82	$3,890.24	$31,828.85
1982	$61,515.51	$3,813.96	$33,832.20
1981	$60,309.33	$3,739.18	$35,961.64
1980	$59,126.79	$3,665.86	$38,225.11
		FV@8.42%	$542,109.96
		Regular Retirement Plan Benefit (From Table 6)	$1,421,727.09
		Total benefit upon retirement	$1,963,837.05

Scenario 4: Retirement Benefits in States not Participating in Social Security and a 2.58% Contribution to a Supplemental Plan

This scenario makes a more conservative assumption regarding the supplemental contribution rate and equalizes the total employee contribution rates for both participating and nonparticipating states. When the 6.2% OASDI withholding tax is taken into consideration, one could say that the total employee contribution rate for SS participating states is 10.66% (4.46%[17] to the retirement plan and 6.2% in OASDI withholding). Therefore, it seems reasonable to analyze the total retirement benefit for individuals in nonparticipating states based upon the same 10.66% contribution/withholding rate. Since the employee contribution rate in nonparticipating states is 8.08%, an additional contribution of 2.58% is assumed to be invested in a supplemental plan, thus bringing the total contribution rate up to 10.66%.

As illustrated in Table 8, the total retirement benefit under this scenario is $1,647,314.78 ($1,421,727.09 from the DC and $225,587.09 from the supplemental plan). This total retirement benefit is just over $27,000 higher compared to the total retirement benefit under the Social Security participating state scenario (# 1).

[17] The average employee contribution rate in states participating in Social Security, as illustrated in Table 1.

Table 8 – Retirement Benefits in Nonparticipating Social Security States with 2.58 % to Supplemental

Year	Salary	Nonparticipating and 2.58% to Supplemental Acct.	FV@8.42%
2009	$105,000.00	$2,709.00	$2,709.00
2008	$102,941.18	$2,655.88	$2,879.51
2007	$100,922.72	$2,603.81	$3,060.75
2006	$98,943.85	$2,552.75	$3,253.39
2005	$97,003.77	$2,502.70	$3,458.17
2004	$95,101.74	$2,453.62	$3,675.83
2003	$93,237.00	$2,405.51	$3,907.19
2002	$91,408.82	$2,358.35	$4,153.11
2001	$89,616.49	$2,312.11	$4,414.51
2000	$87,859.30	$2,266.77	$4,692.37
1998	$86,136.57	$2,222.32	$4,987.71
1998	$84,447.62	$2,178.75	$5,301.64
1997	$82,791.78	$2,136.03	$5,635.34
1996	$81,168.42	$2,094.15	$5,990.03
1995	$79,576.88	$2,053.08	$6,367.05
1994	$78,016.55	$2,012.83	$6,767.80
1993	$76,486.81	$1,973.36	$7,193.77
1992	$74,987.07	$1,934.67	$7,646.56
1991	$73,516.73	$1,896.73	$8,127.84
1990	$72,075.23	$1,859.54	$8,639.42
1989	$70,661.99	$1,823.08	$9,183.19
1988	$69,276.46	$1,787.33	$9,761.19
1987	$67,918.10	$1,752.29	$10,375.57
1986	$66,586.37	$1,717.93	$11,028.62
1985	$65,280.76	$1,684.24	$11,722.78
1984	$64,000.74	$1,651.22	$12,460.62
1983	$62,745.82	$1,618.84	$13,244.91
1982	$61,515.51	$1,587.10	$14,078.56
1981	$60,309.33	$1,555.98	$14,964.68
1980	$59,126.79	$1,525.47	$15,906.58
		FV@8.42%	$225,587.69

		Regular Retirement Plan Benefit (from Table 6)	$1,421,727.09
		Total benefit upon retirement	$1,647,314.78

Preferred Scenario

In an effort to achieve parity, the total benefit upon retirement in a state contributing to Social Security (Scenario 1) is compared to the total retirement benefit in a nonparticipating state in which the employee contributes 2.58% to a supplemental plan (Scenario 4). This equalizes the employee contributions/withholdings for both participating and nonparticipating states. As discussed in the previous section, the total retirement benefit is approximately $27,000 higher for the employee in a state not contributing to Social Security compared to an employee in a state contributing to Social Security. The $27,000 difference is really not a significant amount considering the overall retirement benefit is over $1.5 million. However, this difference could change dramatically if the assumptions such as investment returns and/or life expectancy are varied. Thus, when comparing Scenarios 1 and 4, which one is preferred?

The total retirement benefit under Scenario 1 has the advantage of longevity. Obviously, the longer one's lifespan, the greater the duration of Social Security benefits, and the higher the present value of these benefits. The main disadvantage of Scenario 1 is the uncertainty regarding the future of Social Security benefits. Due to underfunding issues, changes to the current regulations may have to be made that will adversely affect the value of the benefits. Some of the changes that have been discussed include increasing the full retirement age, increasing the OASDI tax, or simply reducing monthly benefits. In addition, annual individual benefit statements sent out by the Social Security Administration now warn that the fund will only be able to pay 78 cents for each dollar in scheduled benefits by 2037 if no changes are made to the current system.[18]

Under Scenario 4, there are several advantages. First, individuals have complete control over all of their investment dollars in the DC accounts. They can allocate all of their contributions to their respective retirement plans based on their risk tolerance, rather than having to pay 6.2% of their income to the government in the form of the OASDI tax. Second, upon the retiree's death, the account balance will go to the decedent's heirs. Under Scenario 1, Social Security benefits will cease once the retiree dies.[19] Third, the higher the investment returns on the invested dollars, the greater the retiree's total account balance in the DC plan. The annual investment return of 8.42% may be viewed by some as rather conservative. Recall that this is the average return in the equity markets over the last thirty years and takes into account the disastrous 2000-2009 decade in which the returns were virtually zero. If you consider the average return in the equity markets over the last eighty years, the figure is closer to 12%. While no one can predict what the future returns will be, if one could achieve an average return higher than the assumed 8.42% under our scenarios, this would indeed have a positive impact on the total account balance for the DC plan.

Employer contribution rates can also significantly affect an individual's account balance. Although the mean employer contribution rate is used for the calculations in this paper, it should be noted that lower contribution rates mean significantly less dollars over time. Conversely,

[18] http:www.ssa.gov/mystatement/sample1.htm.

[19] It should be noted, however, that if the deceased retiree was married, it is the lesser of the two Social Security benefits that are eliminated. Therefore, it the spouse's Social Security benefit is less than the retiree's benefit, the spouse's benefit would be discontinued and she/he would receive the retiree's Social Security benefit.

higher contributions rates can significantly increase an individual's account balance compared to the mean contribution rate. Among the states not participating in Social Security, Illinois, Louisiana, and Ohio are making employer contributions below the average whereas Alaska, Colorado and Nevada are above the average.[20] This may be one factor a potential faculty member should consider when looking at employment opportunities.

Employee contribution rates are not as much of an issue because individuals can control the amount they are contributing to a certain extent. For instance, if the required employee contribution rate in a particular state is low, additional contributions can always be made to a supplemental account.

CONCLUSION

The benefit under Scenario 3 with a 6.2% contribution to a supplemental plan is greater than the total benefit under Scenario 1 (the Social Security eligible scenario) by $343,538.53. However, some may consider this an unrealistic comparison since the employee contribution rate to the regular retirement plan is already higher than the employee contribution rate in the SS participating states. Therefore, a second more conservative supplemental contribution rate was used in a fourth scenario which still marginally outperformed scenario 1. Based on the difference an individual faces by being employed in a state not contributing to Social Security (scenario 2), it is clear that one should consider contributing to a supplemental plan to make up the difference created by the inability to obtain social security benefits at retirement age. The question then is how much to contribute.

Given the above analysis of Scenarios 1 and 4, and taking into account the disadvantage and advantages of each, it appears that Scenario 4 represents the preferred option overall for a faculty member. This option provides faculty the most control over their total retirement plan contributions as well as the best opportunity to take advantage of investment returns.

[20] See Lawrence, Lajaunie, and Mauldin (2010) for a further discussion of employer contribution rates per state.

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MENTORING IN PUBLIC ACCOUNTING: HAVE WE FULLY EMBRACED THE CONTEXT?

Timothy J. Fogarty, Case Western Reserve University
Alan Reinstein, Wayne State University
David H. Sinason, Northern Illinois University

Abstract: After a promising start in the late 1980's and early 1990's, the study of mentorship in public accounting has not materially progressed. This paper reviews the literature inside and outside the profession to conclude that the unique aspects of the work and its organization have not been properly considered by those that would study mentoring in accounting. Ideas for subsequent research are offered.

Despite considerable investment in formal training and the infrastructure to deliver it, public accounting firms continue to depend upon mentoring as an important means to accomplish professional development. The idea that the wisdom of elders should be passed down to members of subsequent cohorts remains central to plans for the continuity of the organizations that provide accounting services to the public.

Mentoring provided academic accountants an interesting and worthwhile phenomenon to study. Contributions could be made that would improve its effectiveness. The mentoring effort served as a critical mechanism that combined the psychological predispositions of individuals with the practical means by which the firm was organized and could inform larger questions of socialization and professionalism.

Several decades ago, the tension between professional and bureaucratic dimensions of public accounting served as a focus of serious academic attention (e.g., Sorensen, 1967; Sorenson and Sorenson, 1974; Montagna, 1974). Since then, concern over professionalism has declined. We apparently have achieved comfort with the decision that public accounting is no more than a set of business organizations that share a specialized service industry. In many ways, mentorship bucks this consensus by restoring the notion of dyadic learning from a close personal relationship that may not be part of an organizational chart. Thus, the study of mentoring is closely connected with the status of accounting as a profession in which skills and values are passed down from one generation to another.

The record of accomplishment in the area suggests unfulfilled potential. When work was done, the insights it produced were limited. For the most part, the contributions remain unrealized. This track record may have contributed to the decline in the number of studies that have been published in this area.

This paper suggests that insufficient attention to contours of public accounting made a material contribution to the problems of the mentoring literature of this discipline. Studies needed to be less modeled after the corporate environment and more sensitive to the team-based, client-focused orientation of modern professional service firms.

The balance of the paper is organized into five subsequent sections. The first provides basic definitions and dimensions of the mentoring relationship as it has been developed by the wider literature. The second section outlines the salient characteristics of public accounting that should be considered in mentoring studies. The paper ends with a discussion that fits the study of mentoring into larger behavioral and sociological themes.

MENTORING RELATIONSHIPS AND PROGRAMS

As long as people have pursued collaborative work, the need for the purposeful transmission of skills and knowledge have been necessary. Usually done on an intergenerational basis, some people pass to others their know how and their insights so that progress can be made. The collective good is served when such a relationship enables the efficacious accomplishment of the group. This describes mentorship, an enduring association between two people, one of which (the mentor) guides the success of the other (the protégé or the mentee).

Although people have always taught other people, mentorship implies more than a single lesson that is communicated and learned. Mentorship implies more of an ongoing relationship between the parties, and a subject matter that is sufficiently robust to require much practice and to face considerable resistance to accomplishment.

The modern organizational field, populated as it is by people with diverse training and zero-sum objectives, provides a dynamic context for mentorship operations. Specific roles constitute the organizations, requiring particular behaviors and prohibitions. How these roles are enacted drive the success of the organization which can vary from the enrichment of the stakeholders to the squandering of their invested resources. In such environments, role incumbents amass significant proprietary human capital that can be used to bring about good results. As individuals progress to other roles, the organization is benefited if previous incumbents are willing and able to inform current role occupants about such best practices. Good advice, timely provided by mentors to protégés, should also facilitate the career development of the parties.

Modern organizational life is quite complex and deeply nuanced. Differential achievement requires not just technical knowledge, but also political savvy and the display of appropriate values. Much exists on a symbolic level, and the gap between reality and perception persists. That which undergirds and undermines performance often cannot be found in the documentation that organizations produce to describe what behaviors are encouraged and stigmatized. The advice of someone with previous experience and broader perspective allow more novice personnel the ability to differentiate the ropes to skip and the ropes to jump.

In its purest application, mentoring exists apart from the hierarchical lines of supervision. Whereas vertical superiors do provide a degree of constraint and encouragement sufficient to motivate their charges and to ensure that the work is adequately performed, mentorship seeks a higher return. Residing apart from, and on the side of, formal supervision, mentorship pursues differential advantage for the protégé. Whereas a supervisor should be fair to all subordinates, a mentor is an unabashed advocate that selects out the protégé for prominent rewards from superlative accomplishment. Thus, mentorship is more concerned with finding and grooming leaders than it is with the routine processing of the organization’s work.

Perhaps fueled by its ambition, mentorship tends to be a highly charged, very personal relationship between people. The mentor and protégé are participants in a voluntary relationship that works best when there is positive interpersonal “chemistry” between the parties. That people need to bring their whole selves to the table is valuable in that the artificial line that separates work and personal life can be erased, leading to more complete investment of energies. However, such a relationship also jeopardizes the parties, in that the protections of a delimited script and a zone of personal privacy are somewhat forfeited.

Organizations, observing the advantages of the mentorship that have organically flourished, have tried to formalize such relationships. Programs wherein mentors are assigned to novices, and time is set aside for meetings are well-intentioned but of limited value. The magic of mentorship tends to work best when it taps into the voluntary and the irregular, that in many ways is oppositional to the bureaucratic and the formally rational.

THE NATURE OF PUBLIC ACCOUNTING

This section attempts to provide a thumbnail sketch of the salient features of public accounting that should enter into the design of mentoring studies of that domain. As a professional partnership servicing a diverse array of corporate clients and producing a mostly intangible product, cultural differences should be anticipated.

Mentorship is a sufficiently flexible idea to find robust application to just about any industry or profession, but we should expect variation in the rationale supporting the initiative, i.e., the benefits expected and perhaps costs involved. This section reviews mentorship studies of accounting organizations. A single industry application of this sort allows a more detailed examination of how mentoring wraps around the specific dilemmas and constraints of practice.

Public accounting organizations present an interesting arena for this application. As a pure service provider, people and their skills represent the only material generator of their income. Thus, they should be very concerned with their staff's complete development. These organizations also represent the purest and most prestigious form of practice for the accounting profession, making the pre-entry experiences (i.e., education, licensure) quite homogenous. This similarity should reduce the variability usually found in the ranks. Professional status also means that behavioral norms from outside the employing organization work as strong elements for members. That public accounting organizations are organized as partnerships is also consequential. The prospects for upward mobility include joining the ranks of the firm's equity owners, a higher elevation than any corporate promotion could be.

Careers in Public Accounting

Although softened in recent years, the classic model for accounting careers began with recruitment out of the college ranks. The prospect of life-time employment with one firm, culminating in admission to partnership, was seriously entertained by all parties as the objective, and as the success story well-worth pursuing. This model creates intense pressure to find the right people while recruiting and to develop raw talent into appropriate professionals.

The classic career path in public accounting has two obvious systemic flaws. First, as the firm invests in their staff, they increase their external market value. Accountants with public accounting firms are highly visible to clients and other organizations. Accountants with large firm work experience are highly marketable. This creates a voluntary turnover problem for accounting organizations. At the same time, promotion within the firm creates a problem regarding those not elevated. Public accounting uses an "up or out" model that mostly requires the replacement of those passed over with new recruits. In other words, those not progressing toward partnership have incentives to leave the firm or are directly asked to do so, adding to the organizational turbulence.

Thus, by virtue of the value of the experience provided and the design of their organizations, public accounting firms experience high levels of turnover. The managerial

challenge is to avoid the turnover of the very best professional staff and to facilitate the turnover of the rest. Because out-placed staff often takes key management positions with existing or potential client organizations, they are sometimes referred to as “alumni” and looked at as a future business development resource (Iyer et al. 1997).

Mentorship would appear to nicely fit these human capital aspirations. If the firm could identify entry level staff with “the right stuff,” the best mentors could be deployed. Kleinman et al. (2001) reason that this should reduce turnover by imparting firm values and goals. Other research suggests that turnover is reduced by virtue of having a mentor, and is further reduced by having a firm partner as mentor (Viator and Scandura, 1991). The better able the firm was at identifying protégé talent, the more effectively mentor resources could be concentrated. However, mentorship may also increase the very market skills that make accountants valuable to other employees, possibly increasing turnover (Hall and Smith, 2009). This tendency might be obscured when multiple functions of mentoring are specified. For example, career development mentoring appears to be associated with lower turnover intentions (Scandura and Viator, 1994).

Public accounting has been recognized as a high stress environment for some time (e.g., Senatra, 1980). Staff accountants are given heavy workloads. Pressure intensifies during “busy season” (Sweeney and Summers, 2002). Staff members are aware of the need to signal their competence by not complaining about the work and sometimes even underreporting their actual hours at it (McNair, 1991). The high stress levels that this environment produces leads to several undesirable consequences, including unprofessional behavior (Margheim and Pany, 1985), burnout (Fogarty et al. 2000), and deteriorated health (Heian, 1985).

Many who leave public accounting cite work-life balance concerns that might point to the practice’s stress environment (Scheuermann et al. 1998). This turnover, as well as progression toward it, can be very costly to the firm (see Manning et al. 1996; Laws, 1996), creating an incentive to more adequately counsel staff about managing sources of stress and their reactions. Mentoring has been shown to help ameliorate stress in public accounting. Staff with mentors reported lower levels of role ambiguity and job burnout (Kleinman et al. 2001). This appears to have positive psycho-social results for upper level as well as lower level employees, and therefore is somewhat robust across different types of stress (Rigsby et al. 1998). This empirical support confirms more general expectations that mentoring would be of value when role-related stress becomes extreme (Brockner et al. 1992). The level of satisfaction that mentoring is capable of producing in public accounting may be conditional upon specific mentoring design features and mentor behaviors within those parameters (Viator, 1999).

Siegel et al. (2001) report that mentoring in public accounting is more pronounced at mid-career, reflecting these organizations’ particular career ladders. Entry level-staff (juniors) appear to be rarely mentored. The large numbers at this rank would stretch mentoring resources too thin. The firm probably awaits the sorting process to unfold, and the strongest candidates to emerge from what is essentially a laissez-faire environment. Fewer resources are devoted to partner mentoring, perhaps in the outdated belief that all partners are fully formed, self-sufficient professionals. More modern views recognize that partners also form a pyramidal structure, testifying to the need to progress from the low to the high ranks. Historically, firm mentoring attention has been devoted to the passage from senior staff to junior partner.

The concentration of mentoring in public accounting also reflects sub-disciplinary assumptions of a bygone era. Historically, staff self-sorted into one of three specialties (audit,

tax, consulting) and worked wholly within that specialty. More recently, much more track shifting has occurred, perhaps influenced by the overall demands of the business. More people are now entering the firms at mid-career to respond to sudden changes in demand. The consultancy track has also splintered and created the need for many more unpredictable personnel changes. The classic grooming-for-partner mentoring model needs to be elaborated and made much more flexible to accommodate lateral movement. With career paths much less preordained, career mentoring in public accounting has to become more customized and more available on a just-in-time basis.

In sum, mentoring motivated by concerns for careers in public accounting used to be well-understood. A system to work closely with the “best and the brightest” tried to cultivate the next cohort of partners. Less attention was focused on the needs of lower level staff, perhaps aggravating turnover in those ranks. Environmentally induced organizational structure changes leads to the questioning of classic mentoring distributions within these firms.

Public Accounting Work Flow

Unlike corporate employees, public accounting staff members tend to work on a project basis. Particular engagements call for ad hoc teams to be formed consisting of people with the talents and backgrounds to perform the anticipated work. This organizing structure exposes the staff accountant to the direct demands of clients and a variety of supervisors. This creates significant learning and constitutes high quality work experience. Time pressure to finish the work within the budgeted time to be able to move onto the next project requires the willingness of staff to absorb considerate uncertainty in the work.

The need for mentorship in this environment is apparent. The weak supervision of engagements is usually not seen in other industries. Having many supervisors (most of whom possess little more expertise than the protégé) is tantamount to having none; the over-arching wisdom of a more seasoned individual is required. Accordingly, Viator (2001) found that mentoring is effective at reducing role ambiguity. However, it tended to increase role conflict.

Given the nature of the work flow, mentors can make many important contributions. Providing and buttressing the protégé’s feelings of competence and capability would prove very important in such a pressured and lightly structured environment (Day and Allen, 2004). Mentors can also be a guide to the customs of the locales that such work requires protégés to visit (Adler, 1994). Again as a result of expectations for self-organizing, team dynamics may prove problematic. Mentors can be instrumental in helping protégés get the best out of other people and managing their reputation as a contributing player. For the latter purposes, team-based outcomes have received little attention in the mentoring literature (see Baugh, 1992). Perhaps most important, mentors are able to abstract away from the specifics of an engagement to focus the protégé upon transferable knowledge (Ostroff and Kozlowski, 1993).

While much learning is possible in focusing on accounting team’s work, not all engagements are equal in their career value. Which assignments an accountant is placed on may be as important as performance for these purposes. Assignments vary in their visibility, their importance to the firm and their likely successfulness. Mentors in such a setting should be able to steer their protégés toward assignments that will be reputation-enhancing and away from those with limited up-side potential. Viator and Scandura (1991) suggest that the mentoring process provides opportunities to find “important” assignments to showcase protégé skills.

Before reaching that point, however, the mentor might prefer assignments that present sufficient challenge to develop those protégé skills that will be of value in the future (see Kleinman et al. 2001). Less attention has been given to the fact that young accountants without mentors might find themselves routinely assigned to work that does not make the firm much profit or work that is more drudgery than dynamic or to clients that are difficult to work with. However, mentors may be less than perfect in their ability to predict good places for protégés, as Andersen partners once viewed Enron as a plum assignment for young accountants.

The dynamic nature of the work of modern public accounting puts a premium on mentorship as a source of stability. As lateral transfers to new areas become even more commonplace, mentor advice on the viability of such prospects becomes important. New directions announced by the firm might prove to be "ground floor" from which successful careers might be launched, or easy reasons to be jettisoned in the future. Mentors might be useful in providing inside information about the depths of firm intentions. To the extent that mentors are highly placed within the hierarchy of partners they too are less likely to be marginalized or washed away by a re-organization. As technology accelerates, the push toward the "virtual office" mentorship may be more important as a means to establish one's importance to the firm in anticipation of radical outsourcing and downsizing. However, this human touch of mentorship may be more difficult to accomplish in such an IT-facilitated world.

Notwithstanding its social organization, the work of public accounting also involves judgment. The accountant must align client situations and treatments with statutes and/or professional standards. This cannot often be reduced to simple protocols or recipes. Mentoring should be important to such an esoteric process. The ability to work in a highly complex and multi-faceted world that lacks clear markers of right and wrong cannot develop overnight. Instead, a painstaking process of trial and error is rather inevitable. Well-timed advice bolsters the courage needed to press forward.

To the extent that learning is the ultimate objective for the protégé, peers may play an unusually salient role in public accounting. The fractured division of labor through work assignments makes everyone's work experience sufficiently different so as to be unusually instructive. With the landscape of the practice and its politics in constant flux, multiple reads on the status quo are worthwhile even if stable roles as mentor and protégé do not exist. Everyone in public accounting needs to be constantly gathering feedback so as to make informed choices in the future. The strength of the resulting networks allows them to function as social capital throughout the careers of the members (Sellers et al. 2010).

In sum, mentorship fits nicely into the work expected of accountants—partly due to the unique team structure of the work flow, but not limited to it. People working in public accounting accept low levels of certainty and thus are likely to need a mentor or its equivalent.

Diversity in Accounting Organizations

Although accounting has attempted to compete for the services of the "best and brightest" of every generation for some time, it has struggled to draw talent from women and minority groups. Women have progressively filtered into staff accountant ranks. With more women than men now receiving accounting degrees, they now are correspondingly well-represented in the ranks of newly hired staff. However, progress moving up the career ladder in public accounting has been much slower. Scheurermann et al. (1998) reports that less than 1% of the partners in the national accounting firms were women in the late 1990s. More progress has occurred in the last decade. However, this promotion rate lagged behind the corresponding

feminization of the leadership in professions such as law and medicine.

The rate of inclusion for minority group members has been more problematic. Sufficient numbers of non-white members have not taken entry-level positions. As a result, very few get to be considered for partner. The problem has resisted many good intentions and specific initiatives (see Weisenfeld and Robinson-Backmon, 2001). Turnover among minority group staff has to be treated as a more pressing problem for the profession.

Work toward increasing the representation of females in high positions in accounting begins with the recognition that the profession has not been friendly to the family focus of women. Exit interviews with departing female staff routinely surfaces some sort of inter-role conflict, wherein the heavy demands of the job could not be accommodated (Hooks and Cheramy 1994). Although many have responded to this evidence with suggestion for the modification of the job, the magnitude of work expectations and our conception of the accounting career (e.g., Almer et al. 2005], mentoring may also help. For these purposes, mentoring has been equated with other programs such as flexible scheduling and low-cost daycare (Hayes and Hollman, 1996) despite fundamental differences in such solutions. Female accountants appear to be more receptive to the idea of mentoring, compared to their male counterparts (Kaplan et al. 2001). Unlike males who seem to believe that they need be self-sufficient in career management matters, women seem to pursue both emotional support and informed consultation.

Unfortunately, women seem to be impaired by the same lack of similar, senior mentors as observed in the broader literature (Viator and Scandura, 1991). As a result, they are less immunized from turnover. The fact that female protégés receive higher levels of social support from female non-partner mentors (Scandura and Viator. 1994) is not sufficiently compensatory.

Minority group members working in public accounting appear to have been even more cut apart from mentoring resources than women are. Despite broad recognition of the potential contributions of mentorship to accounting (e.g., Siegel et al. 1999), gains have not been significant. The dominant culture of the organization may seem alien to talented people from some ethnic and racial groups, and could easily be translated by mentors. However, this work does not appear to be done with any great frequency.

Program-level Considerations in Accounting

Siegel et al. (1995) stresses the major issue of the relative effectiveness of informal and formal mentoring in public accounting, which the last 15 years have not yet resolved. Public accounting has adopted informal mentoring techniques since the inception of the industry in the USA nearly 100 years ago. Anecdotal accounts are often recorded in the histories of firms, usually codified as the lessons of the principal partners and founders. For the most part, good results have been noted, especially for white male accountants (Scheuermann et al. 1998). The quality of informal program results tempts many toward the belief that a formal program would be possible. Unfortunately, no detailed descriptive report of a firm-wide formal mentoring program appears in the literature.

Viator (1999) comes closest to answering the question of the comparative benefits of formal and informal programs in public accounting. Using survey methods, he finds that neither creates more imposing barriers to finding mentors. Formal programs can effectively substitute for more traditional and less explicit ones.

Siegel et al. (1995) examined a smaller scale attempt at two firms. They found some merit with each program. The formal program had the advantage at lower organizational levels but the informal had better results for more advanced members. The formal system had advantages with regards to technical skill development. However, the informal system produced better results in interpersonal skills and personal development. Essentially, this study was inconclusive on overall merit.

A second study concerned a temporary mentoring system installed to smooth a large merger between accounting firms. The stress and uncertainty generated by the transaction resulted in very active use of mentors at all levels of the firm (Rigsby et al. 1998). The hasty implementation, leaving formal mentors without the information they needed to satisfy their protégés, caused participants to resort to informal networks of support. Informal mentoring created more self-sustaining demand than did formal mentoring.

The Rigsby et al. (1998) results, although not very generalizable to more ordinary times at a public accounting firm, are consistent with other studies of formal initiatives installed by firm management. In general, participants tend to resist new and unfamiliar formal approaches, resorting to conventional known logic. Dirsmith and Covaleski (1985) show how a new Management by Objectives performance evaluation system became an unsubstantive ceremony. Fischer (1992) reports on the automation of an audit procedure. Instead of replacing the predecessor as it was designed to do, this technology was merely added onto the work and used only because it was required by the firm. Formal mentoring might face a similar fate.

Without much of a track record of formal mentoring, public accounting has not moved toward the measurement of the value of mentoring. Some might perceive this as ironic because some quantification protocol, such as ROI computations, is exactly the sort of tool that the consulting arms of the accounting firms would suggest for their clients.

Along similar lines, accounting firms have not grappled with the costs of mentorship. Among the barriers to mentorship listed by Kaplan et al. (2001) are none more important than the cost of the time that participants are willing to put into the effort. However, the opportunity cost of a CPA firm partner's time could be quite high. Accordingly, shortages of willing mentors are likely to persist, dampening hopes for larger scale programs. Protégés also need to be convinced that seeking out mentors would be a good use of their time (Kaplan et al. 2001).

CONCLUSIONS

The current crisis in financial markets may trigger broad changes for public accounting organizations. The premise that the audit is a valuable tool of corporate accountability is not immutable. Changes induced by technology, outsourcing and downsizing however will not alter the need for good people in the profession. In fact, organizations required to undergo large changes will probably need even better people. This imperative will continue the profession's fascination with the promise of mentoring.

This paper has shown that mentoring should find good applications in public accounting. The salient features of accounting make a strong mentoring experience instrumental for a vibrant professional. Of particular note is the prototypical trajectory of careers that the individual is likely to make. Good mentor relationships are also important as a defensive buffer against the high stress environment and a fractured supervisory matrix that is likely to be in place for public accounting.

Although the prospect of mentorship is such that good results are likely in any purposefully endeavor, accounting seems particularly receptive to its value added proposition. Sharing the “emotional intelligence” and political savvy dimensionality of what it takes to get ahead in any organization, mentoring in public accounting needs to include a strong skill-based component. The judgments made in accounting careers are essential to ones reputation and one’s human capital. How one makes good decisions in low-structure environments cannot be reduced to textbook knowledge on training provided formulas. If accounting is the textually rich learning context that it appears to be, absorbing the accumulated wisdom from those that have gone before seems to be critical.

As much as organizations attempt to roll mentoring out as formal relationships, the fact that it involves a personal relationship between individuals will not be gainsaid. A commitment to mentoring cannot be done without parallel resolve to recruit intelligently and to embrace the personal cultures that people bring to their jobs. This means extracting from the diversity of talents that are available and attempting to match such abilities to the service lines offered by the firm. Mentoring is capable of preserving and exacerbating, but must be seen as part of a broader enlightened personal management effort.

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TOTAL HEALTH MANAGEMENT: THE ROLE OF THE ACCOUNTANT

Robert G. Morgan, East Tennessee State University
Martha M. Pointer, East Tennessee State University
Paul E. Bayes, East Tennessee State University
Gary G. Berg, East Tennessee State University

Abstract: Health care costs are a major and ever-increasing business expense. Direct health care costs per active employee have risen at a compounded annual growth rate of approximately 6 percent since 2004 with costs per active employee reaching $7,932 in 2007. In total, employers are spending approximately $13,000 per employee per year in both direct and indirect health related costs. While businesses find increasing health care costs are applying great pressure on earnings, they feel that they must incur these expenses in order to recruit and retain productive employees. This paper explores ways that increases in health care costs can be mitigated and describes the role of accountants in the process.

INTRODUCTION

Health care costs are a major, and ever-increasing, business expense. Yet, firms must incur the expense in order to recruit and retain productive employees. Health costs per active employee have risen at a compounded annual growth rate of approximately 6 percent per annum since 2004, and costs per active employee reached an average of $7, 932 in 2007 (PWC, 2008). Employers are the ultimate purchasers of health care for the majority of Americans, spending approximately $13,000 per employee per year on both direct and indirect health related costs (Partnership, 2006; Fronstin, 2008).

Additionally, the U.S. Department of Labor statistics indicate that there are approximately 137 million non-farm employees, and the overall annual cost of poor health on the workplace is estimated at $1.8 trillion (Bureau, 2009). Health care costs have consistently outpaced inflation and have reduced worker's earning power (Segalco, 2009). The 2005 Business Roundtable's "CEO Economic Outlook Survey" found that 43 percent of the respondents reported that rising health care costs were the greatest cost pressure on U.S. businesses (Business Roundtable, 2005). This result is consistent with the two previous years' results.

Currently, employers are addressing the cost of health care by increasing employee contributions and reducing benefits. The results of this approach may have the opposite effect from what is intended. By shifting costs to employees, employers have created barriers to health care access that may lead to delays in attaining health care that, in the end, worsens clinical outcomes and negatively impacts productivity (Fronstin, 2008).

TOTAL HEALTH MANAGEMENT

Total Health Management (THM) is one of several approaches that can be used to attempt to reduce health care costs. THM has the same focus as safety and quality improvement programs: reduction of costs while improving the efficiency of operations. THM is defined as a process that includes all parties involved in providing health care services, with the goal of delivering health care in a more cost efficient and effective manner, thereby

improving the well-being of all employees. For example, an airline and a publishing conglomerate using THM were able to reduce the increase in costs to less than five percent per year without reducing benefits, while many similar plans were increasing at a 15 percent rate per year (Mathews, 2006).

Before implementing a THM plan, a firm must design a strategy with measurable outcomes. As conditions change, a company must consistently follow up and revise the strategy and change the measurable outcomes. By revising the strategy and measurable outcomes the company can maximize the benefits of THM. A strategic approach, which is a long term approach, fits a THM plan well because behavioral change takes a long time to successfully implement.

For THM to be effective, a firm must to be able to tie health care costs to incentives. Further, the system that the firms use to accumulate health care information requires transparency concerning how the data is accumulated and provides timely data to support the decision-making process. While this is occurring, federal regulations requires that individual medical data cannot be revealed or used as a reason for dismissal. Because accountants have the expertise, they should be involved in the design of the information system to support the THM initiative, and in the development of the internal controls to protect sensitive data.

In addition to the previously mentioned factors, a financial incentive for employees seems to improve the participation rate. A 2008 Health and Wellness Touchstone Survey found that 69 percent of companies offer wellness programs and less than 30 percent of eligible individuals participate in the program (PWC, 2008). With financial incentives, participation increased by 129 percent compared to those working for employers who did not offer such incentives. (PWC, 2008)

Financial incentives take many forms such as gift cards, cash or premium incentives. Other examples include such items as:

- on-site screenings which cost less than physical exams
- payments for at-work weight loss programs
- gym memberships or reimbursements based on progress reports
- cash rewards for wellness assessments (PWC, 2008)

The choice of programs has to be tailored to the individual firms needs. Accountant's can help develop the wellness incentive program by analyzing the data concerning employee health to identify specific health needs, leading to informed decisions by all participants concerning an effective incentive program. Some of the companies participating in a major research study subsequently provided to the investigators information concerning how they utilized their health and productivity report in designing their corporate health strategies and included, among others, the following items:

- Integration of their corporate health strategies is very important to them. Companies are seeking integrated solutions that span the health continuum from wellness to complex care
- This integrated health and productivity information was shared with members of their senior management and leadership teams often including members of their C-Suite (CEO, CFO, and COO).
- Employers found that the productivity of their employees at work (presenteeism) was significantly impacted by behavioral health issues (eg, depression, anxiety, GERD, fatigue, sleep disorders etc.), heightening the need for more integrated focus in this area. In several cases this led to integrating behavioral health resources through their

Employee Assistance Programs more effectively with their chronic condition management providers.
- Several employers are changing their benefit plan design to focus more on health improvement by trying to increase participation and more active engagement of their employees in their wellness, health management, and condition management programs.
- The companies with international workforces are keenly interested in health improvements and their link to productivity improvements. Therefore, even though in many countries the employer does not directly pay for the medical and pharmacy costs of health care, the costs of health-related productivity loss are compelling them to invest in global health and productivity enhancement strategies.
- They also expressed interest in seeing a more broad based adoption of health-related productivity metrics in the industry. They would like to see absenteeism and presenteeism as additional outcome measurements for evidence based medicine and provider pay for performance criteria. They think the evidence used to determine best practices needs to go beyond clinical outcomes or financial outcomes and include functional outcomes— impacts on health and productivity.
- They realize that the impact of a healthier, more productive workforce is quantifiable; when combined with other business measures it helps determine the overall economic value of an enterprise (Loeppke, eta al, 2009).

To improve health care outcomes employers must increasingly involve employees in health care decisions. Additionally, employers must provide employees with the educational tools necessary to make informed decisions and the financial incentives to encourage employees to implement their decisions.

TOTAL HEALTH MANAGEMENT AND WELLNESS

Improving the health of employees can provide a significant benefit to an employer by reducing health care costs, reducing employee turnover, and improving on-the-job productivity. To attain this goal many employers have implemented worksite health promotion or wellness programs to better manage their employees' medical expenditures and boost worker productivity (Bowen J, Goetzel R, et al., 2009). There is a growing recognition that promoting employee health is a more efficient approach to achieving cost savings (Goetzel R, Carls G, Wang S, et al., 2009).

Currently many firms take the silo approach to health care wherein they focus exclusively on of health care costs and incidences of healthcare claims. What is missing from employees' health care program is the implementation of "presenteeism". Preventeeism is defined as being on the job but, due to health issues, employees are operating at less than full capability. Presenteeism decreases the benefits of an improved health strategy. A study of the association between health risks, absenteeism and presenteeism found a mean absenteeism rates range from 0.0% to 6.3% for employees with zero to eight risks and a presenteeism rates ranging from 1.3% to 25.9% for zero to eight risks. (Boles et al 2004) A second study found an association between the number of risk factors and absenteeism, with the number of workdays lost ranging from 4.1 days for employees with zero risk factors to 12.6 days for those with four or more risks. (Tsai et al 2005) A third study found an estimated productivity loss of 11.9% to 28.3% for employees with zero to seven or more health risk factors, respectively, finding a 2.4% excess productivity loss per additional risk factor. (Burton et al 2005) Employees at medium risk (three to four risk factors) were 6.2% less productive than employees at lower risk (zero to two risks), whereas employees at high risk (five or more risk factors) were 12.2% less productive

(Burton et al 2005).

Using a wellness score based on behavioral health risks, mortality risks, and the use of preventive services, it was estimated that there was a decrease in total annual medical claims costs of $56 (in 1999 dollars) for each additional point improvement on a wellness scale. (Yen et al 2003) A study examining the relationship of health risk factors and pharmaceutical expenditures found a $76 (in 2000 dollars) average annual increase in drug expenditures for each added risk factor. (Burton et al 2003)

A review of health promotion programs suggested that these programs decrease absenteeism; however, the results differ depending on the type of employee. Employees characterized as hourly and with three or more health risks gaining the most benefit from their participation in a health promotion programs (Aldana and Pronk 2001). Another study on the changes in health risks and presenteeism estimated that there was up to a 9% improvement in presenteeism for each decrease in the number of health risks, concomitantly they found a 1.9% increase or decrease in productivity for each increase or decrease in health risks (Pelletier et al 2004 and Burton et al 2006). A meta-evaluation of 56 studies concerning the economic outcomes of health promotion programs underscored the challenge in comparing different analyses and synthesizing the findings into a single message. The studies varied in terms of methodological approach with almost 70% being limited to the evaluation of one endpoint. Although the range of values for percent changes of each studies outcomes showed wide variation, the average reductions in health care costs, disability, and absenteeism from the introduction of a health promotion program was 26.1%, 32.0%, and 26.8%, respectively (Chapman 2005).

Failure to have an all-inclusive approach and only measuring medical and pharmacy claims may have resulted in an understatement of overall health care costs. Several studies have concluded that, on average, for every dollar employers spend on a worker medical or pharmacy costs, the company absorb at least 2 to 4 dollars of health-related productivity losses (Loeppke, et al, 2007; Edington, et al, 2003). The U.S. spends more on health care, than most other countries, but does not produce a notably healthier population. Part of the solution involves selecting a more efficient, higher quality health care provider and reducing the incidence of unnecessary tests. To achieve a reduction in health care costs, a firm can implement an all inclusive approach to assist employees in making a more informed health care decision. For example, a 2007 survey of 573 US employers reports that 72% offered health risk appraisals (HRAs), (National Business Group, 2007) whereas a 2002 survey of health plans reports that only 64% of 50 million covered members were offered HRAs (AHIP, 2002). HRAs are but one approach that can be used to reduce health care costs. The aforementioned survey implies that health care costs and improved employee health are becoming more important in firm strategy.

THE ACCOUNTANT'S ROLE IN TOTAL HEALTH MANAGEMENT

Prior to the implementation of a total health care program, accountants need to be involved to evaluate the costs and potential benefits of the proposed plan. After the health care program has been implemented, accountants need to reevaluate program costs and benefits. On-going review and evaluation needs to be a part of the strategic process. Some of this is outside the purview of accounting, such as specific health care programs, but elements such as health savings accounts, cost and benefits of health care screening, and incentives to employees for changing their attitudes toward health care are part of traditional accounting. Accountants can work within the information systems to determine the total dollar costs of the

health care program, and the benefits derived from improved health care. For example, accountants can determine the total cost of health care plans to a firm and evaluate alternative plans from third party providers. Accountants can be utilized to identify the largest claims areas and then health care intervention can target these areas. The specific intervention process is outside the expertise of the accountant, but they can help identify the most cost effective plan for the firm and its employees. Accountants can also estimate the cost of various incentive programs, and with the assistance of health care professionals, identify the programs that best fit the overall strategy of the organization.

Precise measurement is a requirement for a successful Total Health Management plan and, firms implementing a THM plan should focus on:

- Services and disease states that are driving trends in plan costs
- Other factors driving health care cost increases
- Plan participants who are utilizing health care services extensively
- Benchmarking key costs and utilization results to peer groups (Segalco, 2009)

The design of the information systems is an important element in the successful implementation of a THM plan. Strategically, the system needs to have the ability to acquire and use real time data. First, information on employee health care expenditures must be available and analyzed on a timely basis so trends can be spotted and timely changes can be made to the program. Accountants, working with health care professionals, can analyze expenditure patterns and predict future costs. Second, employee choice of health care services can be improved if data about performance of health care providers is provided along with financial incentives to choose preferred physicians or facilities (PWC, 2008). One requirement of an effective THM program is having “real time” claim data to identify high plan utilization participants and high health care costs (Mathews, 2006). Accountants are trained in identification of costs and cost patterns. Thus, analyzing data in an information system quickly, allows firms to rapidly respond to changes in cost patterns. An integrated information system allows accountants to analyze and measure the costs of the wellness program and to use the internal and external resources effectively. By identifying the cost driver’s of a program, continuous improvement can be used to identify performance gaps, evaluate benefit plans and barriers, and evaluate intervention programs.

In instances where companies establish a self insured fund to pay for employee health care costs, accountants can aid in developing and maintaining a viable fund. Using information concerning employee health care trends, estimate future costs of health care and expected returns on the fund’s assets; the present value of the fund and payments to the fund can be calculated. Various methods may be used to implement a THM. One approach to moving THM from concept to action is provided by the following five steps:

- assess current capabilities of vendors to support a THM strategy
- assess health care data to develop a pattern of expenditures and possible cost savings areas
- establish priorities to match the strategy with risks identified through previous and future expected claims
- chose health care providers that can support your strategy and hold them accountable through agreed upon benchmarks use the information system to communicate improved healthy living conditions (Matthews, 2006)

CONCLUSION

The implementation of total health management, including a wellness program, brings measurable benefits to an organization including increased employee productivity due to a reduced incidence of absenteeism due to health related issues. The hidden costs of health care are the decrease in productivity due to presenteeism. Absenteeism and presenteeism effects all employees, including management, and not knowing its effects on productivity could result in management making decisions that have long-term negative consequences for the firm. To remain competitive firms have to reduce their overall costs of operation. THM can assist in cost reduction through increased productivity due to better health and reduced absenteeism. Improvements in employee health will provide the company with long-term reduction in health care costs and aid in the attainment of a firm's strategy. A proactive investment in health care can be leveraged into a more productive work force.

The skills needed to determine the costs of a THM program is within the purview of accountants. Accountants training, skills and experience in measuring and analyzing financial and other data, position them to accurately measure the costs associated with a THM program and the benefits derived from a THM program. As such, accountants may often be the key to implementing and maintaining and effective and cost-controlled total health management program.

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