Making Conversation
How word of mouth influences marketers and consumers
Dedicated educators change the world in fundamental ways with the questions they ask. When you understand what your students think and why they think that way you can entice and engage them to grapple with challenges facing modern businesses. They, in turn, work with peers to develop a philosophy that fits their experience, later moving on to apply their unique abilities and personal styles throughout their careers.

Our students eventually spread out across the globe to become presidents, CEOs, and other powerful influencers in companies large and small. They apply the lessons learned here, changing the way business is done for the betterment of society.

Faculty members in the College of Business pursue their research with passion because they understand this basic fact. Aside from the personal satisfaction that comes with new intellectual insights, faculty members know that the more they learn, the more they can pass on to the business community through scholarship and classroom collaboration. This provides both a challenge and an opportunity to influence how business is conducted across our country and the world.

Perspectives strives to present thought-provoking coverage that I hope will leave you enlightened and inspired about the professional challenges we see all around us. I encourage you to become a student again as you read on, choosing to share what you learn with your peers and in so doing help us to change the world one step, one story, one person at a time.

Larry DeBrock
Dean
THE WORD ON WORD OF MOUTH
By Cathy Lockman
How online communication changes the marketing conversation.

THE CASH STASH
By Doug McInnis
Many U.S. companies are flush with cash and they’re holding on to it.

REVVING UP A NEW BUSINESS
By Cathy Lockman
From start-ups to franchises, what are the keys to successful entrepreneurship?

RIPPLE EFFECTS
By Doug McInnis
With international standards taking center stage, the U.S. accounting profession faces the challenges of change.
Nothing gets you to listen up and take notice like a powerful message delivered by someone you trust. It’s why children obey their parents, why patients heed their doctor’s advice, and why citizens follow their leaders. It can influence what career you choose, what neighborhood you live in, and what car you drive. It’s word of mouth, and it’s a very valued form of communication.

It’s also a very persuasive one, which explains why word of mouth is so important in the world of marketing.

“We know that word of mouth can be extremely powerful as a persuasive tool to get you to try new things and to change attitudes,” says Tiffany White, assistant professor of business administration. “Consumers often seek word of mouth when trying to make a decision.”
Coming in Loud But Not Always Clear

But what is word of mouth and how is it communicated? Paul Revere delivered some of the most famous and effective word of mouth when he warned that the British were coming. That oral tradition continues when neighbors talk over the fence, co-workers share stories at the water cooler, and family members offer opinions and experiences at the dinner table.

But such face-to-face communication is no match for the speed and influence of cyber word of mouth. The Internet has ratcheted up the level of opinion sharing, supercharging it and making it instantaneous. From the “Forward” and “Reply All” keys to instant messaging to blogs and social networks like MySpace and Facebook, the potential for letting people know what you think has risen to dizzying levels.

“The influx of traffic online has given people an increasing forum to express themselves and to receive information,” says Kate Niederhoffer, vice president of measurement science for Nielsen Online, a firm that provides measurement and analysis of audiences, media, and behavior in the online environment.

“People have the ability to amplify their own thoughts and opinions and amazing accessibility to other people’s opinions and thoughts. It’s a profound change in how we receive and process information.”

Today’s marketers recognize the potential and are looking to harness it.

“Online word of mouth has important implications for marketers,” says White. “Traditional sources of product information, like TV commercials, can be so easily ignored as people tape shows and zap through commercials. Consumers are increasingly turning to peers for that information, and the Internet provides a vehicle for it to be easily disseminated.”

Sharon Shavitt, professor of business administration, agrees. “Younger generations, especially, are becoming more cynical about mainstream advertising, which increases the gap between the influence of traditional media and word of mouth.”

According to both Shavitt and White, the ability of marketers to reap the benefits of online word of mouth rests on the credibility of the message—and the messenger.

In Word of Mouth We Trust

Trust is key to delivering a message that will resonate with consumers. And as the chart on page 4 illustrates, word of mouth is the most trusted form of marketing communication.

“A brand is absolutely more credible when the message comes from the consumer,” says Shavitt. “The belief that the communicator has nothing to gain is the most important factor in trustworthiness. On the other hand, when a marketer is associated with the source of the communication, the consumer has reason to be skeptical. There is a world of difference between an advertisement from the marketer and word of mouth from someone who uses the brand.”

But how do you know who to trust when you’re online?

It can be a tricky question because of the potential anonymity of the

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– SHARON SHAVITT
Internet. Is the review you read on Amazon.com written by an objective reader or the aunt of the book’s author? Are the comments you see posted on Complaints.com truly those of a disgruntled plasma TV purchaser or an employee of a rival company? For many, it is tempting to use an online identity to downright deceive or, at the least, to manipulate the conversation. Take the case of John Mackey, chief executive officer for Whole Foods. In 2007, it was discovered that he had been posting on Yahoo! Financial message boards under a pseudonym, “Rahobed,” a scrambled version of his wife’s first name. For six years, he had been praising his own company and making dire predictions about a rival, Wild Oats Markets. “In the online environment, there is an extra layer of uncertainty and risk, so you have to look for credibility cues by evaluating the content of the information more carefully and by being more discerning,” explains White.

Ann Schlosser, who earned her Ph.D. from the University of Illinois and is now an associate professor of business administration at the University of Washington, has conducted research that focuses on these credibility cues. Her study of online movie reviews concluded that consumers are looking for consistency between numerical ratings and content when determining who to trust.

“If a review has both pros and cons but has a high numerical rating, it isn’t as credible to the consumer,” she says. “If there is inconsistency, consumers question the sincerity of the review.” They are also more likely to be persuaded by a less favorable review than a positive one, because there is a perception that being critical indicates independence and competency. Entirely positive comments, on the other hand, can create skepticism that the review is contrived.

Consumers are becoming more savvy in how they assess online word of mouth, White says. “Justification is increasingly important in determining credibility.”

What’s a Marketer to Do?

Next time you’re sitting at your computer, go to Google and type in a brand name. The corporate website won’t be the only result that comes up; in fact, it might not even be the first one to appear. Corporate marketing efforts share cyberspace with product blogs, online forums, and other consumer-generated word of mouth—all of which carry more weight with the consumer than corporate communication.

For marketers, who are used to controlling the word on their products, this is uncharted territory that requires new ideas and strategies.

According to White, it’s all about listening. Smart companies don’t look to control word of mouth but rather facilitate it by creating websites that allow consumers to talk to each other and to offer their comments on a brand. “When you co-create with the consumers, you can watch the communication and leverage it. It provides you with valuable information you wouldn’t have any other way. Of course, there are risks because the talk can also be negative.”

In fact, studies have shown that a satisfied customer will tell an average of three people about a product and a dissatisfied customer will share negative feedback with eleven people. Multiply that times the power of the Internet and you can see why companies would be tempted to control word of mouth.

“But marketers are realizing that any attempt to control it will be at the company’s peril,” says Shavitt. “There are ethical implications for companies that...
When Neighbors Talk, Investors Listen

Looking for a stock tip? For many people that advice is as close as your next door neighbor or the woman on the next treadmill.

Research conducted by Scott Weisbenner, associate professor of finance and Julian Simon Memorial Faculty Fellow, indicates that, when it comes to making choices in your portfolio, word of mouth plays a big role.

“In communities where word of mouth is strong for selection of brands, word-of-mouth communications is typically strong across the board, including for investment decisions,” says Weisbenner.

And his data backs that up. The study used a database of stock portfolio information for 35,000 clients of a large discount brokerage firm from 1991 through 1996. The clients remained anonymous; however, zipcode information was provided, which allowed the researchers to evaluate whether investors were more likely to choose a stock that was also favored by their neighbors.

The neighborly preference is particularly true for local stocks, with people investing up to one-third of their portfolio in nearby firms. “This local bias can be due to three factors,” says Weisbenner. “Simple familiarity with the firm, access to locally available information, and word-of-mouth communication with neighbors. You can get information on local companies through your neighbors who work there or are otherwise connected.”

Who Talks the Most?

According to Weisbenner, “the word-of-mouth effect is stronger in more social states.” By that, he means states that rank highest in social interaction on a scale designed by Harvard Professor Robert Putnam. In his index, North Dakota, South Dakota, Vermont, and Minnesota had the highest sociability scores, with Nevada, Mississippi, Georgia, and Alabama ranked lowest. Weisbenner’s study found more investors following their neighbor’s lead in those high-ranking states.

Why would people choose to take the advice of their neighbor over an expert? Trust is one very important reason, says Weisbenner. But there are some more practical reasons as well, including efficiency and cost.

“Word of mouth is a substitute for acquiring information from other sources, like using a broker or conducting your own research, both of which have upfront costs in terms of time and money,” he explains. “Relying on word of mouth is one way to reduce the time commitment and the fixed costs.”

But is it a smart way to make stock decisions? It depends. Listening to others can be a way to learn about promising opportunities, but it can also be limiting. “The local bias may cause investors to be too concentrated in a few stocks,” says Weisbenner. “It is not in the investor’s best interest if word of mouth leads to an undiversified portfolio.”

Money Talks

Word of mouth has the potential to play an even more significant role in the investment realm as employers move away from defined benefit plans and toward defined contribution plans, which give the employee more choice in the investment decision.

“The need to educate employees about the choices will increase the word-of-mouth effects in the workplace. As people learn more about investments and talk more about them, there are information spillovers that have implications for the investment community and the broader society.”

“Word of mouth is a substitute for acquiring information from other sources, like using a broker or conducting your own research, both of which have upfront costs in terms of time and money.”

– Scott Weisbenner
Bill Macaitis, a 1996 graduate in business administration, is the senior vice president of online marketing at Fox Interactive Media (FIM). A division of News Corporation, FIM is a worldwide network of leading social networking, entertainment, sports, and information websites, including MySpace, FoxSports, Photobucket, IGN, AskMen, and more than a dozen others that together comprise one of the largest audiences on the Web. In March 2008 alone, there were nearly 169 million unique visitors to FIM’s various sites, according to ComScore Worldwide.

How does your online marketing department work to promote word of mouth?
We serve much like an in-house agency working with each of the different sites to increase their overall traffic and provide the highest return on investment. We focus on both search engine optimization, which is finding ways to get our sites to come up first when the consumer goes to Google or other search engines, and search marketing CPC (cost per click), which includes working with the sites to create targeted ad campaigns.

How do you measure word-of-mouth traffic?
We utilize internal web analytics such as Omniture and Hitbox and third-party traffic measurement services like ComScore and Hitwise, which track how many people visit your site, how many pages they view, the content they view, and where they’re coming from. These provide excellent insight into what sources are driving traffic and that allows us to make smart decisions on what marketing media works best to reach our audience.

What are ways that companies can step into online marketing?
It’s important to start by answering some basic questions: Do you have your own blog? Do you have direct communications with your users? Do you know who your most passionate advocates are? The answers to these questions will help guide your strategy. From a practical standpoint, hire an online marketing manager and carve out a budget. You may start small with a paid search campaign and then work your way into creating online profiles and tapping into word-of-mouth marketing through social networks like MySpace.

What do you think is the most important vehicle for word-of-mouth communications?
I’m somewhat biased here, but I do believe word of mouth and social networking go hand in hand. The younger generation is so motivated by contact, and they respect what their friends and members of their social networking communities have to say. Plus, with more and more people going online, there are hundreds of millions of users who are connected in these communities, so if a word-of-mouth campaign is carefully executed it can spread like wildfire.

What do you say to marketers who are cautious about entering the online world?
For some people online marketing represents change, and this is often resisted because it’s unknown and different. However, I would just say that online can be a marketer’s best friend. It provides incredible targeting, tracking, and insight into your consumers. Be prepared to hear direct and frank feedback on your brand. However, by joining the dialogue you have a chance to shape the conversations and leverage your most passionate advocates to spread your brand.
engage in stealth marketing,” which she describes as a firm enlisting and paying others to chat up a brand and win over unsuspecting consumers.

The Federal Trade Commission recently addressed this issue in response to consumer group complaints, stating that when there is “a connection between the endorser and the seller of the advertised product which might materially affect the weight or credibility of the endorsement . . . . such connection must be fully disclosed.”

The Word of Mouth Marketing Association, the official trade association for the industry, has taken a stand against stealth marketing practices, as have measurement companies, like Nielsen Online.

“We encourage our clients that when you engage with consumers online you must be completely transparent in who you are and what your intentions are,” says Niederhoffer.

Under the Influence

So what can a company do to harness the power of word of mouth? Creating the type of website White suggests is an important first step. Identifying who is speaking the loudest online about your brand is a second.

There are some people who just naturally are more motivated to influence others,” says Shavitt. “If you can identify these opinion leaders and win them over, it can pay big dividends for your brand.”

But who are they and how do you find them in all the noise on the Internet? Niederhoffer has a theory about online influencers. They are people who speak with authority, who are popular, who speak volumes, and whose word spreads quickly.

She explains that there are ways to measure each of these four characteristics by seeing how many people visit a given blog, how much people are talking and who they validate as an expert, and how fast an influencer’s comments about your brand spread across the Internet.

“You can identify people who score high on these dimensions and use that information to find the ideal conduit for a specific audience,” Niederhoffer says.

So successful online word-of-mouth marketing means understanding the needs of both the influencer and those who are influenced.

“In the online environment, consumers are absolutely in control,” says Niederhoffer. “Marketers need to listen to what consumers are saying, be receptive to the information, and incorporate it into product development, brand strategy, and marketing communications.”

- Cathy Lockman

Defining Online Word of Mouth

Buzz marketing: Using high-profile entertainment or news to get people to talk about your brand.

Viral marketing: Messages that are designed to be passed on voluntarily and in an exponential fashion via email, much like a virus is passed quickly person to person.

Influencer marketing: Identifying and cultivating key communities and opinion leaders who talk about products and influence others.

Conversation creation: Interesting or fun advertising, emails, catch phrases, entertainment, or promotions designed to start word of mouth activity.

Stealth marketing: An unethical practice designed to deceive consumers about the involvement of marketers in the communication.

Shilling: An unethical tactic of impersonating a customer, where people are paid to promote a product without disclosing that they are working for the company.

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Making Conversation

Millions of online users are creating blogs to pass along their personal commentary, and millions more are listening to them. Who are they and what are they talking about?

- 54% of bloggers are under the age of 30.
- Women represent 46% of bloggers and men 54%.
- 76% of bloggers say a reason they blog is to document their personal experiences and share them with others.
- 64% of bloggers say a reason they blog is to share practical knowledge or skills with others.
- When asked to choose one main subject, 37% of bloggers say that the primary topic of their blog is “my life and experiences.”
- Other topics ran distantly behind: 11% of bloggers focus on politics and government; 7% on entertainment; 6% on sports; 5% on general news and current events; 5% on business; 4% on technology; 2% on religion, spirituality or faith. Additional smaller groups focus on a specific hobby, a health problem or illness, or other topics.
- 54% of bloggers say that they have never published their writing or media creations anywhere else: 44% say they have published elsewhere.

Sheila Youmans Petersen, a web designer at Best Buy, has a childcare arrangement many working mothers may covet. Three days a week, she sets up her computer at her parents’ house and works in their kitchen while the grandparents tend to their granddaughter.

“My job fits into my life instead of being so separate from life,” said the 33-year-old from northeast Minneapolis.

Petersen’s job satisfaction is a byproduct of a new philosophy regarding work and life balance called a Results Only Work Environment, or ROWE. In ROWE, the concept of a 40-hour work week is as anachronous as a floppy disk. Employees do not have any set hours or even a set location; rather, workers are allowed to decide when and where they will complete tasks as assigned.

The program’s mantra: people can do whatever they want, whenever they want, as long as the work gets done.

Developed and embraced at Best Buy’s Minneapolis corporate headquarters, ROWE is now being marketed nationwide. Its founders, Cali Ressler and Jody Thompson — former Best Buy human resources professionals — are the principals behind CultureRx, a consultancy that teaches corporations how to implement ROWE.

The duo recently published a book, Why Work Sucks and How to Fix It, with the intention of making their idea that work is something you do — instead of a place you go — into an industry standard.

“It’s going to take a lot of pressure from the masses of people to get this revolution started,” Thompson said in a phone interview from Houston, where she and Ressler were launching ROWE at an undisclosed corporation. “We need to get a lot of people who have been disgruntled with the way work (has gone) for years and say, “We’re not going to take it anymore.”
Reshaping Work

A Results Only Work Environment redesigns the workplace. It is not flextime, where an employee receives permission to work certain hours, every day, such as 7 a.m. to 3 p.m. Under the tenets of ROWE, an employee may have different hours every day of the week—and not have to seek permission to do it.

The ROWE story started at Best Buy corporate in 2001, when an internal task force was formed to figure out how to make the company a top choice for workers. A survey found that what employees desired most from their workplace was trust, as in trust with their time. This planted the seed for what would become the Results Only Work Environment.

It is now standard for all of Best Buy’s 3,000 corporate employees, they say.

Some of ROWE’s perks: No sitting at your desk looking busy even if you don’t have anything to do, just to make your boss think you are busy. No more comments from co-workers about you being 15 minutes late for work. No more mandatory attendance at meetings.

It’s a professional culture that suits Mark Wells, a 29-year-old eLearning Training Specialist who develops Web-based training programs for Best Buy’s retail employees. Wells is single and lives in trendy uptown Minneapolis. When he accepted his position, many of his friends criticized him for “selling out to corporate America.” Today, those same friends are envious of the lifestyle he has because of ROWE.

He contends his schedule has allowed his current relationship to survive and thrive, since he can spend plenty of time with his girlfriend, a server who often starts her day as late as 3 p.m. During the summer, he rarely goes into the office, instead often opting to travel to his favorite summer music festivals.

“If you can really start to do this program right, it’s seamless and (co-workers) don’t know where you’re at,” said Wells. “Another guy in my department lived in another state for a couple of months. Amazing, right?”

He says ROWE may sound like it’s too good to be true, but it’s not. He addresses some of the common concerns about the program, such as how collaboration happens (mostly online via Instant Messenger, or using text messages). As a result, does he feel he can disconnect from work? Or is he ever chained to an electronic leash?

“I definitely don’t feel like I’m always connected to work,” he said. “I actually feel the opposite of that.”

Of course, Wells and Petersen have 21st century jobs that are highly dependent on technology, and such jobs adapt quite well to this program, but Ressler and Thompson maintain that everyone can benefit from ROWE—from administrative assistants up to the highest executive. Ressler and Thompson’s book has a whole appendix devoted to the “Yeah, but” comments they hear when they describe the philosophy.

“One of the biggest changes that people need to make in order to make a ROWE happen is to throw out the notion that time equals productivity,” Ressler said. “In ROWE, the amount of time it takes to do something doesn’t matter as long as you meet the deadline.”

On-the-Job Freedom

The premise behind ROWE is “nothing new,” said Greg Northcraft, the Harry Gray Professor of Executive Leadership in the College’s Department of Business Administration. For example, faculty members in academia have operated under the premise of results-focused management for decades. In the business world, flextime initiatives and even flexible benefits programs have also attempted to provide employees with opportunities for more freedom on the job, and management-by-objectives (MBO) programs traditionally have focused management efforts primarily on employee outcomes rather than behavior or processes.

“People like having the opportunity to make decisions about the organization of their own work,” Northcraft said.

“AN ORGANIZATION MIGHT LOOK AT (ROWE) AND SAY, ‘WE’RE NOT GOING TO TURN PEOPLE LOOSE COMPLETELY, BUT MAYBE ON THE MARGINS THERE’S A WAY WE CAN GIVE PEOPLE A LITTLE MORE FREEDOM.’”

- GREG NORTHCraft
People like Petersen. Before her team implemented ROWE, she had been laying the groundwork for a major life change. She was attending cosmetology school at night, learning how to style hair, all the while dreaming of opening up her own independent Web design firm.

"I almost feel like I’m a freelancer, which is the job I’ve always wanted to have," she said. "If I have 10 projects that I have due on Friday, if I wanted to I could work until midnight on Monday, Tuesday, and Wednesday and get it done so I have Thursday and Friday off. I could set my own hours, which is what I could do if I was my own boss."

However, Petersen said the rubric of a 40-hour work week still exists at Best Buy, if not in name then in practice. But those 40 hours don’t have to fall between 9 and 5. People do keep track of their time, mainly to make sure that they’re not working more than for what they are paid.

The people who have the most trouble adjusting to ROWE were, not surprisingly, supervisors, said Petersen and Wells.

"The hardest thing for managers is to change from monitoring the hallways to managing the work output," Thompson said.

Wells said the supervisors were the ones “pushing back” when the program began. He recalled some of them not being entirely enthusiastic, but “the good ones would set an example for their team by going to a movie on a Tuesday afternoon,” he said.

In the two years since, Wells said his relationship with his supervisors has shown no ill effects.

“It really puts the onus on them to give me solid expectations and deadlines,” Wells said.

Measuring Results

Both Petersen and Wells report morale to be as high as ever at Best Buy, one of the immediate effects of ROWE.

Ressler and Thompson believe it’s easy to measure the effectiveness of ROWE in more qualitative terms as well. Voluntary turnover rates on teams that follow ROWE at Best Buy, they report, have plummeted, as much as 90 percent in some divisions. Productivity has climbed an average of 35 percent.

“In any company, if people are doing work, there should be some way to measure that. Cali talked about how people look at work right now as pieces of time,” Thompson said. “Work shouldn’t be about pieces of time, work should be about creating an outcome that is measurable, whether that is customer satisfaction or number of sales. You measure whatever you’re hired to do and whatever you’re supposed to do.”

Ressler and Thompson say that Best Buy plans to roll out ROWE in its retail operation, a challenge to be sure.

“It’s unusual in an environment where you wouldn’t expect the workers to be prepared to manage those decisions,” Northcraft said. He noted that autonomy can be great for employees if they are ready for it, but that it can require some training—both of the employees and their supervisors.

Although they realize there are significant obstacles, Ressler and Thompson remain determined to plant the seeds of change at workplaces everywhere. In March they began marketing a ROWE start-up kit on their website.

“Whoever has the passion or energy to change their organization, can do that through one of these launch kits,” Thompson said.

Northcraft believes that they may have an impact, but one perhaps not as big as Thompson and Ressler may hope.

“Organizations will look at this and they will take a piece of it,” he said. “An organization might look at this and say, ‘We’re not going to turn people loose completely, but maybe on the margins there’s a way we can give people a little more freedom.’”

As for Petersen, she has no plans to take up cutting hair. In addition to allowing her to have a unique childcare arrangement, she believes that ROWE has had another effect on her life, one that cannot be measured in dollars and cents.

“I can do laundry and answer emails at the same time,” she said. “It saves me a lot of sleepless nights.”

— Laura Weisskopf Bleill
As a rule, Americans don’t save much. That leaves them with less room to maneuver in today’s economic turbulence. In contrast, many corporations have taken the opposite tack, squirreling away cash during a recent string of hefty profit years.

“We are coming out of good times,” says Heitor Almeida, associate professor of finance. “Corporate profits have been very high. Given that firms are aware of imperfections in the financial sector, they were aware of the need to save cash. And this might mitigate the effect of the financial crisis on the companies that saved.”

There are many reasons firms hoard cash. Almeida and Murillo Campello, associate professor of finance, have been exploring these reasons in a series of papers on corporate cash policies.
When times get tough, a rainy day reserve of cash is one way companies survive. But there is another life saver—a line of bank credit that can be tapped in hard times.

"This is very important if things go wrong," says Heitor Almeida, associate professor of finance. "The key question is—how well do lines of credit work in bad times when the economy is turning south? If lines of credit work well, it would be surprising to see firms holding cash. The line of credit would be an option, so a firm wouldn’t have to worry about liquidity. But in the current market, bank capital is tight, so banks are reluctant to lend, and lines of credit are not working."

The big reason for banks to slam shut their loan windows is the ongoing subprime loan mess. This has battered the profitability of many lenders. Banks have also been singed by rising delinquencies on credit cards, auto loans, and home equity credit lines.

"So the question now is whether banks can honor the business credit lines they have opened," says Almeida. "Credit-line contracts give banks some room to renegotiate. A company may have thought it had a line of credit, but if bad things have happened to it, the company may have to pay more, or, in some cases, the credit will not be forthcoming."

This prospect has set federal policymakers on edge. Their concern is that credit lines will dry up so widely that it will impact the overall economy, spurring a cycle of business failures, followed by even tighter credit.

"I definitely think this is a legitimate fear," says Almeida. "If companies go bankrupt, that increases the losses on bank balance sheets, and then banks will become even more reluctant to extend credit. That increases the likelihood of even more business failures. Policymakers are worried about the snowball effect."

Cashing In

For corporations, the definition of cash is broader than it is for consumers. It includes funds in checking accounts and investments that can be quickly converted to cash, such as money markets. Access to such funds has taken on particular importance lately as banks have begun to close off their lending windows to business in the wake of the subprime home loan mess that has battered bank profits.

The sudden reluctance of banks to lend means cash is increasingly critical to corporations, and not just for weathering the current storm.

"If they have saved, companies can still finance their good ideas," says Campello. "If they haven’t saved, they won’t be able to finance a good idea that could help in the economic recovery process."

That leads to the question—how much cash is the right amount? "Many people focus on the idea that there is some amount of cash you should have," says Campello. "What Heitor and I have found is that this number depends on how easy it is for a firm to access capital."

For some firms, borrowing isn’t much of a problem. For others—such as small, newly formed growth companies—cash is often a necessity. "These firms should have more cash," says Campello, "because in general they have a harder time borrowing. And these firms would have a very hard time borrowing right now."

In particular, technology companies need cash because their assets tend to be intangible—patents, for example. That means they lack the collateral banks want to secure loans. "The banks have old practices," says Campello. "They like collateral like machinery, things they can sell. They don’t like patents."

There are other reasons to conserve cash. For instance, it provides funds for acquisitions. And some corporations may hoard cash because they believe globalization has made the U.S. business climate riskier.
Learning from a Cash Crisis

Both Almeida and Campello are natives of Brazil, a country where the need for cash is well understood. “We come from a country which has less-developed financial markets,” says Almeida. “In such countries, credit is harder to get and more expensive. So if a Brazilian firm has internal profits, it should not go out and spend everything on the expectation that it will be able to borrow on the market, because it may not be able to find a loan at the right price.”

Both men were driven to economics by their own experiences with cash-based financial crises—the period of hyper inflation that wracked Brazil in the 1980s and 1990s. In those days, workers spent their paychecks quickly because cash was worth less by the day. “There were months when inflation was close to 100 percent,” Almeida recalls. “So the price of something would roughly double in a month.”

The experience made economics the talk of the country with both future economists, such as Campello and Almeida, and ordinary Brazilians. “My mom would know the inflation rate, the interest rates, and the exchange rates,” says Campello. “It was something everybody needed to know. That’s how I became interested in economics.”

A Penny Saved

In the bumpy U.S. economy, it has been more useful to save cash rather than spend it. But U.S. corporations began to hoard cash well before the current subprime loan problem was on the horizon. It’s proven to be a smart strategy; this economic downturn has been notable because it has hit the lenders hard. “In the last recession, the banking sector was not a problem,” says Almeida. “It was healthy.”

Now the banks are watching pennies, lest they loan out still more money only to lose it. In addition to widespread defaults on subprime loans, they have been slammed by a growing number of delinquencies on credit card debt, car loans, and home equity loans. This has made it hard for both businesses and consumers to borrow.

In the first half of the 20th century, economist John Maynard Keynes believed it was important for business to save part of its earnings. But since Keynes’ time, the industrialized world has developed sizeable capital markets to serve corporate cash needs. “So to some people it might seem that it’s not as important to have cash on the balance sheet as it was early in the 20th century,” says Almeida.

“Still, firms do seem to follow a pattern of saving part of their profits for the future, instead of paying them out as dividends, for example,” he says. “You can think of this as the same thing as an individual saving for bad times. You save part of your income because you might need it someday.”

– Doug McInnis

In recent years, many corporations have used their high earnings to build hefty cash nest eggs. But companies did have other options. For example, they could have boosted dividends, although this route would have left them with less cash to weather the current economic downturn. “Once the money is gone, it’s gone,” observes Heitor Almeida, associate professor of finance.

Or they could have increased outlays for facilities and equipment in an effort to stimulate the economy. After all, consumers have been urged by the federal government to quickly spend the rebates they will be getting from newly passed legislation designed to kick start the economy.

“I don’t think companies have to worry about stimulating the economy,” says Almeida. “It’s not their job. And if the federal government wants the companies to spend, they could give tax credits for capital expenditures. The government has done this in the past.”

There are, of course, some disadvantages with holding cash. For instance, since companies tend to put their cash in safe, short-term investments so they can quickly retrieve it, they usually get low returns, Almeida explains.
Revving Up a New Business
Denise Maple is a confessed “banker turned biker chick.” It’s a transformation that began when she fell in love with motorcycle riding, and it kicked into high gear when she left her job at LaSalle Bank to start her own business. A part-time pastime has become a full-time passion for Maple since last year when she founded VaVaVroom, an apparel and accessory company geared toward women motorcycle enthusiasts.

A 1990 graduate in finance, Maple is one of millions of Americans forging the entrepreneurial path. In fact, the U.S. Small Business Administration estimates that each year about 7 percent of the working population in the United States is engaged in efforts to start new businesses—a number that keeps growing. In 2005 alone, nearly 672,000 new companies were created, which was 30,000 more start-ups than the year before and over 80,000 more than at the height of the dot.com era in 1996.

Being your own boss certainly has broad appeal, but what sounds good in theory can be very difficult to carry out in practice. How do you take your idea and turn it into a job capable of providing you with the income and benefits you need and want and the potential to do the same for others? There isn’t one sure-fire way to launch and grow a business, but paths followed and lessons learned by aspiring entrepreneurs can help.

Succeed by Meeting a Need

Sometimes a business starts out of frustration. That was the case for Maple, who found it extremely difficult to find functional, fashionable motorcycle wear that would fit. So she set out to do it herself. VaVaVroom was the answer.

The same was true for John Aiello, a 1990 graduate who was “frustrated by how marketing and sales weren’t integrated to enable salespeople to be successful.” In 1999, he and his college roommate started a consulting company that would provide a solution for other companies with similar frustrations. That was the beginning of the SAVO Group, a firm that almost a decade later has evolved from a consultancy to a product company that provides software that enables salespeople to summon their entire organization instantly.

According to Janet Bercovitz, assistant professor of business administration and a 2007 faculty fellow at the College’s Academy for Entrepreneurial Leadership, launching a company because you see a need in the market is one very important key to success. “There has to be a pain in the market that you can resolve,” she says. “To be successful, you have to be focused on the needs of the market. It’s a much harder road to develop a product first, even if it’s a good one, if you haven’t first determined that there is a real need.”

For Matt Menna, a 1993 finance graduate and a partner in Four Corners Tavern Group, the need might seem a little more obvious than fashionable motorcycle gear or sales enablement tools, but the competition is greater too, so the question for him became how to distinguish his new restaurant/bar business in

“I’M NOT A RISK TAKER, SO LEAVING THE CORPORATE WORLD AND DOING SOMETHING THAT’S UNPROVEN IN AN INDUSTRY THAT I WAS UNFAMILIAR WITH WAS A BIG CHALLENGE,”

– Denise Maple
going and a document to get everyone on the same page. It’s a way to keep you moving forward and a way for you to measure progress. But for a business plan to really be effective it must be a living document that is always being revised.”

Aiello agrees, cautioning entrepreneurs “not to get too enamored with that plan.” He urges them to “first get customers, listen to what they tell you, and then be ready to adjust your plan based on that.”

The next question is who can help you execute the plan. While Menna jokes that “the best partner is a successful friend,” he’s serious when it comes to seeking out other professionals to help you. “The fees for legal and accounting assistance might be hard to swallow when you’re getting started, but their expertise and guidance is absolutely necessary and absolutely worth it both as you begin the business and as it grows,” he says. “There’s no substitute for the wisdom of advisors in areas of the business that you don’t know as well.”

Networking is also key. “Before you take the entrepreneurial leap, take time to build your network,” advises Bercovitz. “In fact, it’s key that your career prior to the entrepreneurial venture be a place where you spend a lot of time learning something very, very well and developing a network of colleagues and contacts that you can call on when you’re on your own.”

What about mentors? Aiello says that’s an aspect of entrepreneurship where there’s a void, at least in his area. “Mentoring is so important, but I don’t think there’s a culture in Chicago to mentor entrepreneurship, so we’re working to try to change that,” he says. “It would have made such a difference to me to have advice from someone who had made some of the mistakes I was going to make before I made them.”

From Launch to Growth

If you’re like Maple and the nearly 60 percent of all entrepreneurs who in the first year of operation are the sole employees of their new businesses, you face additional challenges as you take your business from launch to growth.

“As the founder, you need to have the vision to know what your role is and the ability to bring in the right people at the right time to help you,” says Bercovitz. “In the growth stage, it’s vital that you know how to access and assess talent and make the hard choices of who is best suited to grow with the company.”

Aiello says that role often requires a lot of patience. “The biggest challenge as you grow is to find loyal, talented people. I found that it’s better to keep a spot vacant and to keep looking for the right person than to fill one of your positions with the wrong person.”

That also means being willing to give up some control of the business to others. For Menna, who also has a full-time position with an investment firm, relinquishing control is not only important for the business but for him personally. “To keep things balanced and to keep true to the culture we created of ‘working hard and having fun,’ I’ve had to learn to delegate. It’s not easy, but it’s vital.”
For those entrepreneurs who are looking to go into business for themselves but not necessarily by themselves, becoming a franchisee might be just the right opportunity. Certainly, it's a road many business owners pursue. According to the International Franchise Association, there are more than 900,000 franchised businesses in the United States ranging from Dunkin Donuts to Kinkos to Curves to the Dollar Store.

But just what does it take to make a go of it in the franchise world? Steven Michael, associate professor of business administration, recently completed an extensive study of the factors that contribute to franchisee performance and says that success hinges on a combination of three variables: training, commitment, and support.

Training is the most crucial component. "The businesses are not as simple as they may appear to the customer," says Michael. "Even in a large corporation, like McDonald's, each franchisee is a small factory of its own, and getting the details right is a lot of work. The training that the franchisor provides really helps the franchisee to be successful."

Michael also stresses that success is more achievable when the franchisees are all in—that is, when the franchise is their primary line of work and they have invested a fair amount of money into the enterprise. "Just because there's an established formula for a franchise doesn't mean commitment isn't important," he says. "In fact, the effort to pour the extra cup of coffee or police the parking lot to pick up trash really matters in these businesses."

Support comes in the form of a franchisor that provides a brand name, communicates the brand message, and offers a system to put the franchise in place. "The franchisee is buying a production system and a brand name, and the demand that goes with it," explains Michael. "What that amounts to really is buying a share in a hope for success. The value they place in that brand name and production system and the support they get in carrying it out plays a big role in achieving success."

Predictability Versus Surprise

What can start-up entrepreneurs learn from the success of franchises? "The greatest lesson of franchising is the power of the system," says Michael, "the ability to take what you do and make it into a routine that someone else can understand and duplicate. Once you transfer it, you can scale it and teach others."

But the strength of the franchise model is also its weakness. "When you make something routine and quick to produce, you give up the power of craftsmanship," he explains. The product becomes predictable, which is a benefit when the customer wants the same sandwich in Des Moines that he can get in Denver, but it's a disadvantage when the customer is looking for a surprise.

With the needs and wants of consumers constantly changing, there's room for both predictability and surprise—for both franchises and start-ups looking to become a franchise some day.

Students often ask Michael what the odds are of being successful in an entrepreneurial venture. "I tell them that while there is no guarantee, the chance of success is much greater than you think."
possibilities.” It’s a smart strategy, says Bercovitz, who believes it’s important to be looking for ways to raise funds when you don’t need them, so that you’re ready when you do.

Aiello recommends looking at debt financing before taking the venture capital route. “I’m not a serial entrepreneur, but I would say don’t get venture capital backing in your first year. You have a lot to learn and most likely some failure to overcome in that first year. Although the process of venture capital funding was a great discipline for us, I would say use debt first because venture capital is expensive.”

**Making it Personal**

A business plan, cash, and people who you trust to help you are tangible assets for an aspiring entrepreneur. But what are the intangible ones?

Mostly they’re personal. Bercovitz cites “an optimistic attitude, an ability to deal with ambiguity, and a passion for the work” as integral to the success of any entrepreneur.

Aiello agrees. “Only you know your business and your passion, so while it’s important to seek out advice, it’s vital to trust your instincts. Believe in what you’re doing and be decisive. And remember that nothing good happens if you don’t ride it out.”

- Cathy Lockman

The Academy for Entrepreneurial Leadership was launched in 2004 to encourage entrepreneurial initiatives across campus. In the last year:

- More than 100 faculty members taught entrepreneurship courses to almost 4,000 students representing 142 majors.

- The College was named one of the Best for Entrepreneur Double Majors, one of the Best for Entrepreneurial Executive Education, and a Top Program for Undergraduates by Fortune Magazine.

- The Princeton Review and Entrepreneur Magazine ranked the University of Illinois 16th in entrepreneurial education for undergraduates and 21st for graduate students.
Within the next ten years, the United States is likely to switch to the international system of accounting standards and away from its own system, Generally Accepted Accounting Principles. Such a move will mean waves of change for U.S. corporations, accountants, auditors, investors, and university business schools, because the two systems are fundamentally different.

"Some people think a move from GAAP to international standards is just substituting one rule book for another," says Ira Solomon, professor of accountancy and head of the department. "It's anything but."

Even though a shift to international standards will bring fundamental changes, it's unclear whether the international system will be any better at protecting investors from the next Enron or give investors advanced warning of something like the subprime loan debacle.

Still, there are many reasons to change, including the fact that using GAAP has put the United States at odds with the rest of the world. More than 100 countries already use the International Financial Reporting Standards, or IFRS. Recently, the pressure for the United States to move to IFRS has begun to grow, and the Securities and Exchange Commission has thrown its weight behind a switch.

Playing by the Rules

On a purely superficial level, one way to compare the systems is to look at the number of pages filled by the rules. The international system has roughly 2,500 pages; GAAP has ten times that. But the differences aren't superficial. GAAP is a system based on rules. This minimizes the need for accountants and auditors to make judgment calls about issues such as what to include in financial statements or how to calculate key financial data. Conversely, IFRS is a system based on guiding principles, which means practitioners have to make many more judgment calls.

For example, GAAP might have a very specific method for determining the value of a certain type of asset. IFRS might leave the determination of value up to an accountant's professional judgment. The hope is that relying on judgment will give a better idea of what something is really worth.

Sometimes, however, the issue is much bigger. Under GAAP, a company may be able to follow the specifics of a rule, yet still leave something off its books that could wreak havoc down the road.
Enron’s collapse, for instance, was brought about in part because of transactions that were kept off its balance sheets, and thus were hidden from investors. Under a system based on principles, auditors might be able to make the case that such matters belong on the books where everyone can see them.

Has GAAP’s Time Passed?
Traditionally, GAAP has been regarded as the gold standard of accounting because it is so tough on corporations. Whenever there was a problem, the solution was often to create a new GAAP rule that was tougher than the old one—thus 25,000 pages of rules.

For awhile, the addition of more and more rules was seen as helpful, but now the sheer volume has become overwhelming.

“For a long time, GAAP had advantages because it held U.S. companies’ feet to the fire,” says Mark Pecher, professor of accountancy. “It made them report things they did not want to report. But that took rules. Now, there are so many rules that it has increased the complexity of financial reporting, and that may, in and of itself, contribute to stock price volatility. The rules are so hard to figure out.”

A presentation on international standards by PricewaterhouseCoopers reports that: “Complexity of current U.S. standards is taking a toll on domestic companies. Decades of detailed guidance and bright-line answers are difficult to navigate and apply correctly. IFRS offers a sophisticated and simplified platform for a fresh start.”

Of course, the proliferation of rules was in part geared to protect investors, who wonder if they will be any better off under IFRS. One way to explore that question is to look at one of the factors that helped bring Enron down and is now causing fallout in the subprime loan decade—the use of so-called “special purpose entities.” SPEs are legal vehicles that allow a company to keep some things off its balance sheets.

“At the time of the Enron collapse, GAAP rules said if a company did not have financial control of an investment, it did not have to go on the books,” says Solomon. Control was narrowly defined in a way that enabled Enron to keep risky SPEs hidden.

After Enron, the rules were tightened but not enough to head off trouble for some banks, which used SPEs to keep exposure to subprime loan financial instruments off the books. Now the implosion of the subprime lending industry has forced banks to put those instruments on the books, and the result has been very large and growing losses.

The question, of course, is whether IFRS would do any better. “One possibility,” says Solomon, “is that because international financial reporting...”
American companies are considering a merger or acquisition of a foreign firm, they can’t value the other company correctly unless they understand international accounting.

And at home, a switch to IFRS may help minimize a recurring problem—the need to restate results because of some highly technical accounting error.

“Roughly ten percent of public companies restate their financials each year,” says Schmid. Often, the need to restate results is driven by some technical interpretation of the rules. “Potentially, IFRS may be able to drive the restatement trend downward because you don’t have these very detailed technical points that may result in a restatement.”

But making the switch to IFRS will take time, effort, and commitment, not only for auditing firms, but for corporations at large.

“When you talk about changing your day-to-day accounting language,” says Schmid, “that gets into systems, into people, into controls, and how you communicate with your stakeholders. It’s one thing to report under a new accounting language—it’s another to live and breathe and think under a new accounting language.”

Some firms are already preparing to make the switch. The process may be easier for very large firms such as PricewaterhouseCoopers, which rotates employees to countries where IFRS is already used. Even so, there is much to be done.

“We certainly do a lot of rotating,” says Schmid. “But that isn’t enough to get us ready. For our firm, and I would guess for other big firms, we need to train people, from first-year staff to the most senior partner. That’s a process that’s already underway. We have classroom and e-learning training that are ongoing.”

There will also be pressures for college accounting programs to teach IFRS. “The big accounting firms want us to put more emphasis on IFRS,” says Theodore Sougiannis, professor of accountancy.

At Illinois, the shift may be made easier by the way accounting is taught. The College of Business teaches students to think first about the economic logic behind financial transactions. Only after students understand that logic do they apply accounting standards. Because of this, “the curriculum does not depend on the accounting system that is in place,” says Sougiannis.

He offers an example of how this works. “Let’s say you have a long-term lease agreement. What does that mean? Leasing is a means of financing. It’s like you borrowed money. Instead of buying a bulldozer, you have leased it for five years. But in effect, it’s as though you borrowed money for the next five years.”
Once students understand the economic logic behind leasing agreements, they are taught how GAAP expresses that, and then they touch on how IFRS would deal with the same matter. "I cannot say we go into IFRS in detail," says Sougiannis, "but we are planning to do more, starting perhaps next year. The department is thinking more and more about IFRS."

**Legal Liability**

If IFRS does take hold in the United States, the ripples will be felt everywhere. To take a very practical example, suppose the issue is to reflect the value of a building. "A rule-based system would base the value on the purchase price and other factors," says Rachel Schwartz, associate professor of accounting. "The principle-based system would leave the determination of value to professional judgment. That's a more useful figure to shareholders—but it requires the use of estimates, which opens the door to manipulation. The auditor then decides whether the number has been properly determined."

But there is a catch to IFRS that could prove worrisome to U.S. auditors working under the international system. "If the number turns out to be wrong and the auditors get sued, they worry that they won't have an available defense under IFRS," says Schwartz. "It's easier for the management or the auditors to justify a number if they have followed prescribed rules."

This isn't much of a problem overseas, where legal rules discourage lawsuits. Under foreign legal systems, if an investor brings suit and loses, he must pay the defendant's legal costs. That stipulation acts as a deterrent against lawsuits. In the United States, however, the plaintiff generally is off the hook for the defendant's legal expenses. In addition, in the United States, it's possible to get a lawyer to file a case under a contingency fee arrangement.

"Auditors may not get sued more often under IFRS," says Schwartz, "but their ability to defend themselves may be impaired. Anytime you have an estimate, you're not going to be correct 100 percent of the time. After all, when you forecast the weather, how many times do you get it right?"
Whatever the potential liabilities, it appears that IFRS has sufficient strengths to carry the day.

“When I’m talking to clients in conferences, the three points I try to bring home are these,” says Schmid, of PricewaterhouseCoopers. “First, IFRS is inevitable. Second, GAAP and IFRS are different. Many people assume that you get to the same place with either system. Generally, that is not the case. Third, this is not just about debits and credits. This is a business transformation, which can be painful, but also liberating and beneficial in the long term.”

– Doug McInnis

David Light, a junior majoring in accountancy and finance, is also a member of the University of Illinois accounting team that recently reached the finals of a national accounting competition sponsored by PricewaterhouseCoopers in New York City. The debate over Generally Accepted Accounting Principles and International Financial Reporting Standards was front and center at the competition.

For their case, the Illinois team had to analyze the economics of a fictional country and determine whether it was in the country’s best interest to stick with GAAP or switch to IFRS. Their presentation had to include a method for switching and an outline for what the benefits would be. For the fictional country, which coincidentally was described as demographically identical to the United States except for size, the team made the case for a change to IFRS.

That was theory, but what about practice? Light agrees that switching from rule-based GAAP to principles-based IFRS would benefit the United States just as he argued it would for their fictional country.

“If companies use the principles-based system fairly, it will make our financial landscape better and easier to navigate, because the companies will have the freedom to report items in the manner that most accurately reflects their current operations,” Light says.

What does Light think it will mean for him as a business professional?

“The switch to IFRS would affect just about every career in the financial world,” he says. “I currently plan on pursuing a career in investment banking. From the prospective of someone evaluating financials, like an investment banker, you would have to do much more investigation and be much more detailed when going through the footnotes to make sure you’re comparing apples to apples when you evaluate companies.”

For accountants, Light expects the switch would mean “you have a lot more responsibility under IFRS and would have to use a lot more judgment. Auditors will also be under more pressure to rely on judgment. Without as many rules to fall back on, auditors will ideally be forced to build a level of conviction that their client’s statements accurately reflect their company’s operations.”

“The big accounting firms want us to put more emphasis on IFRS . . . we are planning to do more.”

– Theodore Sougiannis
Understanding Customers in Subsistence Marketplaces

Subsistence marketplaces are sometimes referred to as “doubly foreign” because they are typically geographically and culturally distant from the United States and at the same time very different from poor consumers in developed economies. Current research suggests that much of what we assumed about subsistence markets and their constituents may be wrong, and that there are systematic ways to generate traction in these markets.

Business Administration associate professor Madhu Viswanathan has devoted his career to a better understanding of these consumers. Viswanathan and the College of Business are hosting a one-day executive workshop in Chicago on June 13 to explore the opportunities of these exciting high-growth emerging markets. The workshop is intended for current and future practitioners in subsistence markets. It will be facilitated by thought leaders in marketing and provides a venue for interacting with those who have successfully penetrated such markets. The sessions are designed to convey practical insights and apply cutting-edge research to current problems.

For more information, contact: Madhu Viswanathan at: mviswana@uiuc.edu.

The Pivotal Economy

The state of the national economy is taking center stage, and College authorities are offering their expertise on how economic decisions are impacting various sectors.

Debt and the economy. Finance professor Michael Weisbach authored a paper released by the National Bureau of Economic Research examining why firms structure debt the way they do. Among the findings, it was noted that the issuance of short-term debt increases during tough economic times mostly because short-term debt is almost by definition less risky than long-term debt.

Health care and the economy. The College’s Center for Business and Public Policy recently hosted a talk by Peter Orszag, director of the Congressional Budget Office. Orszag shared his office’s advice to Congress about the health care cost problem. Noting a common misconception that aging baby boomers’ medical problems are the primary reason health care costs are increasing, Orszag identified costs per beneficiary as a much larger issue. Reducing such costs requires new research directions, possibly leading to building electronic medical records systems, changing health care delivery systems, altering doctor payment incentives, and doing more to encourage people to lead healthier lives.

Employment and the economy. Despite economic uncertainty, a surprisingly decent job market awaits 2008 graduates, according to Lois Meerdink, assistant dean of career services for the College of Business. Reported salaries are up 3.7 percent from last year, with business students getting an average of $55,000 versus $53,000 last year. Meerdink reported that in general, forward-thinking companies hire for positions that will open up long after this recession recedes. Hot areas like accounting, computer sciences, consulting, and sales cannot afford to miss hiring opportunities as talent takes time to mature.

Converse Symposium Honors Top Marketing Academics

Every four years the College hosts the Converse Symposium to present awards that constitute a “Marketing Hall of Fame,” according to Fortune magazine. The event is sponsored by the Department of Business Administration and the Central Illinois chapter of the American Marketing Association.

Winners who were honored at the 17th Paul D. Converse Symposium included Valarie Zeithaml, a marketing professor at the University of North Carolina. Zeithaml, a pioneer in services marketing, is the first woman honored in the nearly 50-year history of the awards.

Other award winners were Joe Alba, chairman of the marketing department at the University of Florida, who studies how consumer expertise influences decision making; Leonard Berry, an authority in retail marketing and a marketing professor at Texas A&M University; Kent B. Monroe, professor of marketing at the University of Richmond, former J.M. Jones professor of marketing at the University of Illinois and a leading researcher on pricing strategy; and Rajan Varadarajan, a marketing professor at Texas A&M who specializes in services marketing.

“The symposium showcases the best and brightest in the field” says Cele Otnes, co-chair of this year’s symposium along with fellow marketing professor Bill Qualls.

“Having five of the world’s greatest marketing minds on campus is great exposure for our faculty and students,” Qualls says.
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