Center for the Study of Minority & Small Business
Department of Business Administration

Minority and Small Business Review

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Featured Articles

Minority and Small Business Review

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The Minority and Small Business Review is published annually each Spring by the Center for the Study of Minority and Small Business (CSMSB) and the Department of Business Administration at University of the West. This publication includes original contributions based on both theory and practical insights on a variety of topics on entrepreneurship. While the topics may vary, each volume contains articles on subject matters that are critical to the growth and sustainability of minority and small businesses, such as: leadership & management strategies; finance/accounting; access to capital; marketing/branding; and legal/tax issues. The contributing authors include UWest Business Department Faculty as well as industry experts, business leaders/executives and entrepreneurs. Each year, the Review seeks to provide information that is content-rich and topically current.

We invite such articles to be submitted to the Editor via e-mail to meskeremt@uwest.edu (using a standard MS word-processing program such as Word). All submissions are subject to editorial review and modification--acceptance is not guaranteed unless such notification is provided in writing by the Editor.

The annual subscription rate is $10.00 for mailing within USA and $15.00 outside USA. (Please see Order Form). All correspondence regarding contributors' writings, excerpt permission and scholarly exchange; as well as subscriptions, changes of address and request for sample copies, should be addressed to: Editor of The Review, CSMSB, University of the West, 1409 N. Walnut Grove Avenue, Rosemead, CA 91770.

Center for the Study of Minority and Small Business

The Center for the Study of Minority and Small Business (CSMSB) serves as a link between the University and the minority and small business community, offering regular seminars, lectures, conferences, business counseling and the publication of "The Review". The Center seeks to develop itself into an outreach link to connect area minority and small businesses with governmental and non-governmental organizations in order to broaden their exposure to current business realities and changing governmental regulations.

As the Center strives to strengthen its efforts to play a more meaningful role towards the long-term growth and sustainability of minority and small business, it is mindful of the fundamental need for a broad-based support and partnership of area stakeholders and the community at large.

Your subscription to The Review will not only provide us your contact info so we can advise you of upcoming programs and events, it will also signify your support to the Center's programs and activities.

We invite your ideas, feedback, support and involvement. Please address all correspondence to the Center's Director via email @ meskeremt@uwest.edu.

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Minority and Small Business Review

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Featured Articles

Message from Dr. Stephen Morgan, President
University of the West

March 24, 2017

As University of the West closes its Silver Anniversary academic year, I am pleased to present this anniversary issue of our annual publication, **Minority and Small Business Review**. For fifteen of our twenty-five years we have produced this compilation of articles authored by our own faculty members and other outstanding scholars.

We are grateful to our regional entrepreneurs and the successful businesses they have built. To a large extent, these businesses are the backbone of our local economy. They invest in our region, create jobs for our residents, generate local tax dollars, and contribute significantly to the vibrancy of life in Southern California.

University of the West is proud to be a player in the heart of the San Gabriel Valley and pleased to partner with the business community to provide unique educational opportunities to a diverse population of outstanding students who are pursuing both undergraduate and graduate degrees on our campus.

My thanks to all who contributed to the 2017 edition of **Minority and Small Business Review** and special thanks to Professor Meskerem Tadesse who serves as the Director of the Center and Editor of the **Review**.

I extend my best wishes for your continuing success.

Sincerely,

Dr. Stephen Morgan, President
University of the West

From The Editor

March 24, 2017

Each spring for the past 15 years, CSMSB has published the **UWest Minority and Small Business Review ("The REVIEW")**, hosting a collection of business articles on a variety of topics and issues that inform, educate and consult our local business community. These articles are authored by faculty from UWest and other institutions, as well as industry experts, entrepreneurs and business leaders, to whom we are grateful for joining us in this valuable service endeavor.

As our publication marks its 15th year, it is an opportune time to recognize and congratulate our parent institution, University of the West, which celebrated its 25th Anniversary of successfully providing whole-person education to a broadly diverse student body in the heart of our community. This 15th Volume of The REVIEW is thus dedicated to the continued celebration of this major milestone, as we look forward to the next 25+ years in which UWest will continue to play a key role in educating and developing productive and responsible citizens, employees and leaders of our communities.

As we go forward, we reiterate our invitation to our local business community to utilize our institution as a source of educational workshops and seminars that can provide a competitive edge in today's dynamic business environment. Such partnership can yield a win-win opportunity as education and training can enhance business growth, which can in turn generate employment opportunities for our graduates, and lead to further growth in our communities.

Finally, as we continue to explore and develop collaborative partnerships with area organizations, we are happy to report that Wells Fargo-Rosemead has recognized us, again in 2016, as its "Non-Profit Community Partner Organization". We look forward to our continued partnership.

Best Regards,

Professor Meskerem Tadesse, Director
Center for Minority and Small Business (CSMSB) &
Editor, Minority and Small Business Review

Economic Outlook for the Year 2017

By Otto Chang, PhD

The year of 2017 will be a year of uncertainty because of a new administration in the United States. The only certainty will be volatility in markets because so little was known regarding what actual U.S. political and economic policies will be in the next four years. However, campaign rhetoric and actual policies are seldom the same and economic systems in the past have demonstrated an ability for self-balancing and self-correction through dynamic equilibrium process. Therefore, any anticipated changes will take a gradual adjusting process that is somewhat predictable in the long term. It is from this perspective that the following forecasts are provided.

Even the full details of US economic policies are yet to be developed, there are consensus among economists regarding where the US economy is heading for in the next 4 years: federal taxes will be lowered, government regulations will be relaxed, government expenditure (especially defense spending) will increase, federal deficits will climb up, interest rate will be higher, dollar will appreciate in value, and trade deficits will worsen. These shared anticipations are reflected in the consensus of economists' outlook for 2017. The real GDP growth, though disappointing in 2016 (estimated to grow at a rate of 1.6% for 2016), is projected to grow faster in 2017, due to a more pro-business and pro-growth economic environment. Business investment will no doubt lead growth as businesses become more profitable and retain more profit after tax. Government expenditure will increase because of the President-Elect's campaign promises of infrastructure improvement and stronger military might. Housing demand will continue to grow modestly as more jobs are created and wages are raised. But higher mortgage rate will serve as deterrent for some buyers (Wells Fargo 2017). The increase in business profit will benefit business owners than the workers. As a consequence, real personal disposal income actually is expected to decline as inflation eats up some of the wage gains. Real consumer spending, the locomotive of the economy in the past, will decline slightly as real personable disposal income decreases. Unemployment rate is predicted to further decline as business investment expands. Inflation rate, as measured by the Consumer Price Index, will increase because of higher private and government demand and also because of higher import prices through imposition of tariffs or border adjustment tax. It is expected that the oil price will increase due to higher demand and more successful coordination in production cut among oil producing countries (USEIA, 2017).

For the rest of the world, the economic growth is anticipated to be better than 2016. Although there will be some improvement in economic indicators across the global economy, the uncertainty surrounding the speed of future monetary policy changes by major central banks and the U.S. fiscal policies under the new administration could keep global economic growth contained, at least in the near term (Wells Fargo, 2017). The Federal Reserve and the ECM are expected to raise interest rates as inflation rises in 2017. Potential trade wars and currency volatility induced by policy uncertainty can also affect global economy. For example, Argentina is considering going to the international financial capital markets to issue debt before Jan. 20 to pre-empt any market reaction to the U.S. political transition and to get a lower interest rate on debt issuance. Meanwhile, Mexico is experiencing serious social upheaval due to the government's decision to raise gasoline prices in January to offset the depreciation of the Mexican peso caused by President-elect Trump's comment. The rebound in advanced economies will pick up slightly, while the growth in emerging market and developing economies will slow down because of weaker prospects in some large emerging market economies and oil-exporting countries.

The International Monetary Fund pointed out several forces and downside risks that will shape the world economy: political shocks, such as Brexit; ongoing realignments, such as rebalancing in China and the adjustment of commodity exporters to a protracted decline in the terms of trade; and slow-moving trends, such as demographics and the evolution of productivity growth. The subdued economic growth plays a role in explaining the weakness in global trade and persistently low inflation (IMF 2016).

Outlook For The U.S. Economy

Despite the uncertainty of the new administration's policies, the U.S. economy is expected to grow at a faster pace than 2016. For the year ahead, business investment will substantially increase because of a new pro-business environment. Federal spending will grow, unemployment will further decline. Real personal income and consumption, however, will decline because of slow wage growth and higher inflation. Both short-term and long-term interest rates will rise in anticipation that the Federal Reserve will continue to raise interest rate to keep inflation in control.

The consensus among economists is that real gross domestic product (GDP) will grow at about 2.3 percent in year 2017, increasing from the growth rate of 1.6 percent in 2016. Most of major components of real GDP are consistent with this faster growth trend. The real business fixed investment will grow at 3.0 percent (as compared to a decline of -0.5 percent in 2016). Industrial production is expected to increase at a rate of 1.3 percent, compared with a growth rate of -1.0 percent in 2016. Real personal consumption expenditures are expected to grow by 2.6 percent in 2017, representing a slight decrease when compared with a 2.7 growth rate for 2016, caused by a slower growth rate in real personal disposable income (from 2.8 percent in 2016 to 2.4 percent in 2017). Since industrial production grows faster than consumption, inventory buildup will increase in 2017 (33.8 billions), as compared to 2016 (15.3 billions). Housing starts are estimated to gain modestly from 1.17 million in 2016 to 1.22 million in 2017. Car and light vehicles sales will decrease from 17.5 million units to 17.2 million units next year. Oil prices will fluctuate around $53 in 2017, translating into higher transportation cost when compared with 2016. Interest rates are forecasted to climb in 2017. Unemployment rate is forecasted to be at 4.7 percent compared with 4.9 percent in 2016.

Forecasts of U. S. Major Economic Indicators

Major Economic Indicators*	2016	2017
Real Gross Domestic Products	1.6	2.3
Industrial Production	-1.0	1.3
Real Personal Disposal Income	2.8	2.4
Real Personal Consumption Expenditures	2.7	2.6
Real Business Fixed Investment	-0.5	3.0
Changes in Private Inventories (in billions)	15.3	33.8
Net Exports of Goods and Services (in billions)	-554.9	-592.5
Real Government Consumption Expenditures	0.9	1.0
Car & Light Truck sales (millions of units)	17.5	17.2
Corporate Profits after tax	-2.5	1.7
Housing Starts (millions of units)	1.17	1.22
Unemployment Rate	4.9	4.7
Consumer Price Index	1.3	2.4
Two-year US Treasury Bill	0.83	1.42
10-year Treasury Note	1.84	2.52
30-year Fixed Mortgage Rate	3.65	4.5
Oil Price (dollars per barrel)	45.1	53.0

*All numbers are fourth quarter over fourth quarter percent changes unless otherwise indicated.
**Source: Wells Fargo (2017).

In 2016, after-tax corporate profits shrank by 2.5 percent as corporations exhausted all the cost cutting options to cope with lingering weak demands from the great recession. In 2017, it is expected that corporate profits will grow again at a 1.7 percent rate, and continue to grow at 1.6 percent for 2018. As corporations become more profitable, they will hire more workers. The stronger job market means consumers will have more money to spend. But the higher gasoline bills and the higher inflation will dent the consumers' pockets, causing real consumption to growth at a slower rate than last year.

The 2017 national real estate market is predicted to slow down compared to the last two years. Home prices are anticipated to increase 3.9 percent and existing home sales are forecasted to increase 1.9 percent to 5.46 million homes. Mortgage interest rates are expected to reach 4.5 percent due to higher inflationary pressure in the year ahead (Kirchner, 2016).

The S&P 500 finished 2016 with a 9.8% return for the year. The consensus S&P 500 operating earnings per share estimate for 2016 is $118.22.This places the current P/E ratio of the market at about 18.5 times. For 2017, the consensus S&P 500 operating earnings per share estimate is $132.61. If the market P/E ratio remains constant, this suggests a 2017 year-end S&P Index valuation of 2,453. Based on these numbers, the forecast for the return on S&P 500 is about 12% in the coming year, everything else being equal (Light, 2016). Potential headwinds in 2017 include more rate hikes from the Federal Reserve, delay in tax cut or fiscal stimulus, stronger dollar, and long-term structural constraints on post-industrial economy.

Outlook For World Economy

Global economic growth is expected to be 3.4 percent in 2017 as compared to 3.1 percent in 2016 (IMF, 2016). The expansion will be accompanied by stable inflation, around 1.7 percent for advanced economies and 4.4 percent for emerging market and developing economies. The price of oil is expected to fluctuate around $53 a barrel. In the foreign exchange market, US dollars will become stronger as a result of US trade, fiscal, and monetary policies. The euro is forecast to close in 2017 at $1.01 per Euro and Japanese Yen at 122 per dollar (PNC 2017).

In the Americas, Canada's growth rate for next year is estimated to be 1.9 percent, slightly up from 1.4 percent in 2016. Mexico's economy will grow at -1.1% rate, down from 2.2% for the 2016. Brazil's economy will recover from its growth rate of -3.5% in 2016 to a growth rate of 0.8% in 2017. The Argentine economy is expected to recover from a negative 1.8 percent growth in 2016 to a positive 2.7 percent growth in 2017. Chile's growth rate will increase from 1.7 percent in 2016 to 2.0 percent in 2017. Venezuela is expected to reduce its recession rate to -4.5 percent in 2017 as compared to a -10.0 percent recession in 2016 that was caused by severe supply bottlenecks, challenges from capital flight, and weak policy frameworks.

In Western Europe, British economy will grow by 1.1 percent next year, down from the 1.8 percent in 2016 partly due to the Brexit. The Euro area is forecast to grow by 1.5 percent in 2017, down from 1.7 percent in 2016.

In Central and Eastern Europe, the growth rate is different depending on the specific situation in each country as compared to 2016. Russia's economy will improve from -0.3 percent in 2016 to 1.5 percent in 2017. Poland and Romania's growth will be 3.4 and 3.8 percent respectively in 2017, compared with 3.1 and 5.0 percent registered in 2016. Hungary's economy will grow from 2.0 percent in 2016 to 2.5 percent in 2017. Turkey's growth rate will decrease slightly to 3.0 percent in 2017 from 3.3 percent in 2016.

Other than China and India, the economy in Asia generally improve modestly from 2016, benefiting from economic growth in their major trading partner areas. The four countries that will have the largest growth are India, Philippines, Vietnam, and China. In India, consumer spending continues to be the primary driver of Indian GDP growth. Although the recent currency demonetization could depress overall GDP growth in the near term, it is unlikely to have a lasting effect on economic growth in India in the long run. In China, residential investment should decelerate in coming quarters, because lending standards are being tightened again at the margin. Chinese economy will more or less experience a "soft landing," growing at 6.0 percent and 5.5 percent in 2017 and 2018 respectively. The slowdown reflects China's over-leveraged business sector, especially its state owned enterprises which are often kept afloat by the Chinese government.

The following is a table showing the projected growth rates in 2016 and 2017 for the countries in this region.

Growth Forecasts for Asian Countries

Country	2016	2017
China	6.6%	6.0%
India	7.6%	7.5%
Indonesia	4.9%	5.3%
Japan	0.5%	0.6%
Malaysia	4.3%	4.6%
Philippines	6.4%	6.7%
Singapore	1.7%	2.2%
South Korea	2.7%	3.0%
Taiwan	1.0%	1.7%
Thailand	3.2%	3.3%
Vietnam	6.1%	6.2%

Source: IMF (2016).

Risks And Uncertainties

Several risks are inherent in the economic projections presented above. As we head into 2017 with positive momentum, there are some major uncertainties that we need to watch for. These major uncertainties are discussed below.

The U.K. vote to leave the European Union and the U.S. presidential election result have brought to the fore issues related to labor mobility and migration, global trade integration, and cross-border regulation. Institutional arrangements long in place are now potentially up for renegotiation or rearrangement. There is a trend that protectionism and trade wars are more likely to threat global economic growth.

Growth has slowed in China in recent years. There are risks of a stronger global growth slowdown if China's transition to a services and consumption-based economy less dependent on commodity and machinery imports is bumpier than expected.

Underlying vulnerabilities among some large emerging market economies (including high corporate debt, declining profitability, and weak bank balance sheets in some cases) leave emerging market and developing economies still exposed to sudden shifts in investor confidence. Such shifts could materialize, for example, if incoming inflation data for the United States point to an earlier hike in the interest rate than anticipated.

A range of additional factors are expected to influence the outlook in various regions—for example, the drought in east and southern Africa; civil war and domestic conflict in parts of the Middle East and Africa; the unfolding migrant situation in Jordan, Lebanon, Turkey, and Europe; multiple acts of terror worldwide; and the spread of the Zika virus in Latin America and the Caribbean, the southern United States, and southeast Asia. Each of these factors could inflict both immeasurable humanitarian and direct economic costs. Recurrent incidents of terrorism, protracted civil conflict that spreads to contiguous regions, and a worsening public health crisis from Zika could collectively take a large toll on market sentiment, with negative repercussions for demand and activity (IMF, 2016).

Outlook For California Economy

California's economy will continue to expand as the US and world economy continue to grow in 2017. Nonfarm payroll employment will grow at a lower rate of 1.6 percent in 2017 as compared to 2.3 percent in 2016. Regardless, unemployment will shrink to 5.5 percent at the end of 2016 and to 5.3 percent at the end of 2017. Real personal disposal income will increase at 3.5 percent in 2017 versus 2.9 percent in 2016 (Young 2016). California's housing market will post a nominal increase in 2017, as supply shortages and affordability hamper market activity. Single family home resale will increase at 1.4 percent in 2017, compared with a decline of 0.4 percent in 2016. Median home prices will increase from $503,900 in 2016 to $525,600 in 2017. C.A.R. President Pat "Ziggy" Zicarelli commented that "The market will experience regional differences, with more affordable areas, such as the Inland Empire and Central Valley, outperforming the urban coastal centers, where high home prices and a limited availability of homes on the market will hamper sales. As a result, the Southern California and Central Valley regions will see moderate sales increases, while the San Francisco Bay Area will experience a decline as home buyers migrate to peripheral cities with more affordable options." (CAR 2016).

In the Southern California area, the leading industries will be health care and social assistance; professional and business services; retail trade; and leisure and hospitality. Lagging industries will be natural resources, finance and insurance, and other services (LAEDC 2016).

Implications For Small And Minority Business

In summary, U.S. and world economy will continue to grow steadily from previous years at different paces in different countries. Although the change in new US presidency may encourage business investment, the changes may also bring higher market uncertainty and volatility. Businesses should not be overly optimistic about the positive prospect of the new business environment. Instead, they should be aware of the negative forces that can potentially harm the economic outcomes such as stronger dollars, rising wages and inflation, tightening immigration policy, and potential trade wars.

There are things that small business can do to improve their bottom lines in a period of economic uncertainty. On top of all, small firms should continuously try to raise their productivity by incorporating information and communication technology into their operation. Secondly, as global uncertainty increases, the prices of the raw materials are expected to be more volatile in the future. Small and/or minority business should carefully plan their requirements of inputs and materials for the coming year to make sure the cost of them are under control. There are techniques to improve e-commerce, inventory planning, and to manage supply chain. If any business needs assistance, please contact the Center for Minority & Small Business at the University of the West at (626) 571-8811, ext. 380.

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ABOUT THE AUTHOR

Dr. Otto Chang is a reputed accounting and business educator with specialty in several areas, including taxation, management and international accounting, business ethics and philosophy, corporate governance and social responsibility. Born in Taiwan of Asian Heritage, Dr. Chang attended National Taiwan University, receiving a bachelor degree in Economics. He came to University of Illinois in 1978 to complete his Master and Ph. D. degree in accountancy. He taught at the University of Wyoming, Texas Christian University, and California State University at San Bernardino (CSUSB). He was the Chair of the Department of Accounting and Finance, Associate Dean for Administrative Affairs at CSUSB, and Dean of the Doermer School of Business at Indiana University-Purdue University Fort Wayne.

Throughout his educational career, Dr. Chang received numerous awards and recognitions for his outstanding teaching, excellent research, and dedicated service to the community. His professional activities include more than forty-five publications; some of them appear in major academic journals, such as Journal of Accounting Research, Journal of American Taxation Association and Management Accounting. He is often called upon to conduct professional workshops to top-level management from all over the world and serves as consultant to several major firms in the United States and China.

Fraud and Not-for-Profit Organizations

By Fredrick Ho, CPA, MBA

Internal control systems are policies and procedures that safeguard the assets of a not-for-profit organization, provide reliable financial reporting, ensure compliance with laws and regulations and promote effective and efficient operations. These systems include procedures for (1) handling funds received and expended by the organization, (2) preparing appropriate and timely financial reporting to board members and officers, (3) conducting, as needed, an annual audit of the organization's financial statements, (4) evaluating staff and programs, (5) maintaining inventory records of real and personal property and their whereabouts and (6) implementing personnel and conflicts of interest policies.

Weaknesses in not-for-profit organizations' internal control system open the door to the possibility of fraudulent activity. The ACFE (Association of Certified Fraud Examiners) has defined occupational fraud as "The use of one's occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization's resources or assets."

In 2016, the ACFE issued a global fraud study titled Report to the Nations on Occupational Fraud and Abuse. Although the report did not focus specifically on not-for-profit organizations, it clearly presented the global impact of fraud, with the U.S. leading the way as indicated in Figure 1.

Figure 1: Geographical Location of Organizations Victims of Fraud

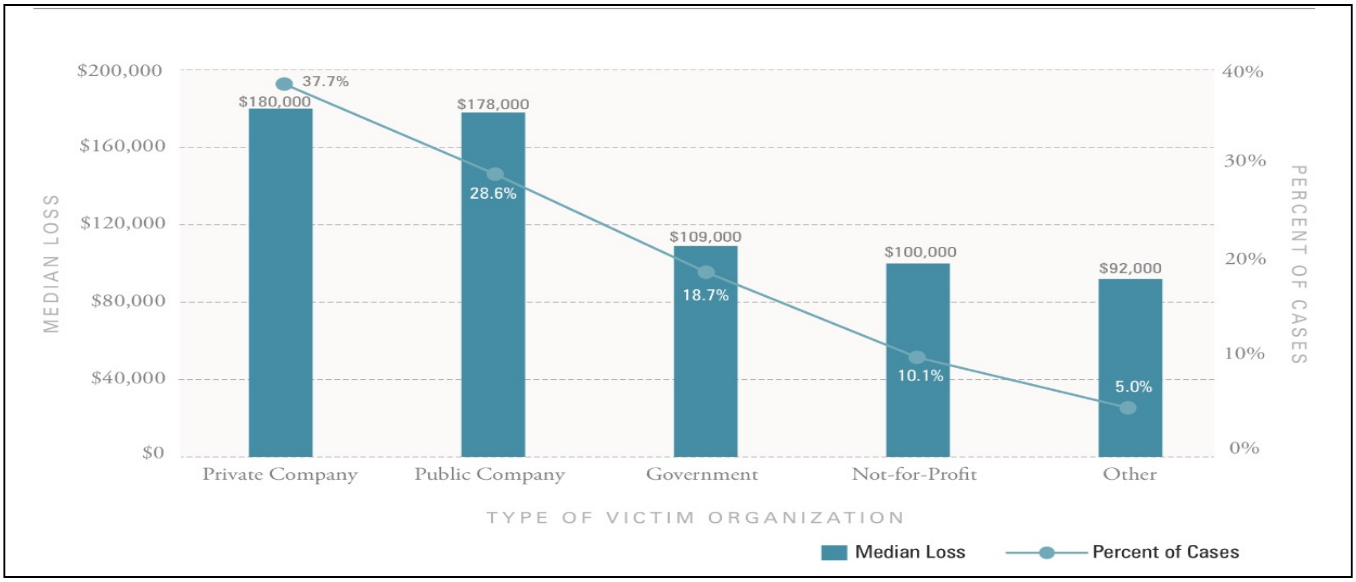
Region	Number of Cases	Percent of Cases	Median Loss (in U.S. dollars)
United States	1038	48.8%	$120,000
Sub-Saharan Africa	285	13.4%	$143,000
Asia-Pacific	221	10.4%	$245,000
Latin America and the Caribbean	112	5.3%	$174,000
Western Europe	110	5.2%	$263,000
Eastern Europe and Western/Central Asia	98	4.6%	$200,000
Southern Asia	98	4.6%	$100,000
Canada	86	4.0%	$154,000
Middle East and North Africa	79	3.7%	$275,000

Source: 2016 ACFE Report to the Nations on Occupational Fraud and Abuse

Frauds Against Not-For-Profit Organizations

The threat of fraud in not-for-profit organizations is clearly presented in the 2016 ACFE report (Figure 2)

Figure 2: Type of Organization Victim of fraud --- Frequency and Median Loss

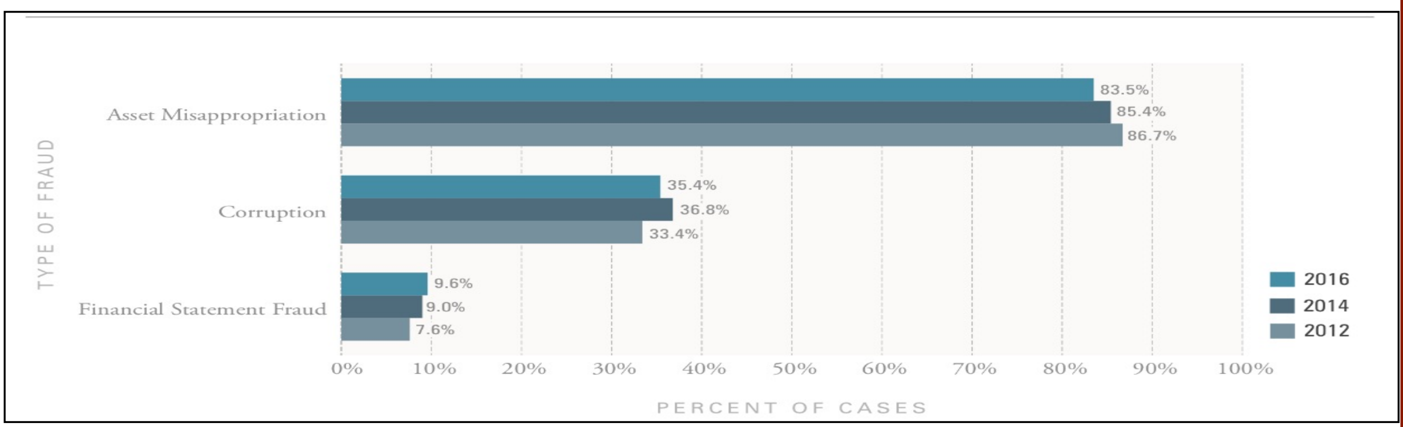


Source: 2016 ACFE Report to the Nations on Occupational Fraud and Abuse

Two major categories of frauds are experienced by not-for-profit organizations - internal and external. Internal frauds are committed by individuals within the organization such as employees, officers and directors. External frauds are perpetrated by individuals outside of the organization, such as vendors, sub-recipients, grant applicants and program participants.

Internal frauds can be broken down into: asset misappropriations and fraudulent financial reporting. Asset misappropriations are the most common as presented by the 2016 ACFE report (Figure 3) and may revolve around such cases as: revenue and cash receipts schemes, purchasing and cash payment schemes, payroll and employee expense reporting schemes and non-cash asset misappropriations.

Figure 3: Occupational Frauds by Category---Frequency



Source: 2016 ACFE Report to the Nations on Occupational Fraud and Abuse

Asset misappropriations:

Revenue and cash receipts schemes

- Skimming, which is the theft of cash before it is recorded on the books. Skimming can be executed by anyone who either initially collects or opens incoming mail, the individual who initially logs in cash receipts, prepares the deposit or takes the deposit to the bank, or door-to-door solicitors of charitable contributions. In addition to cash, checks can also be skimmed. The perpetrator(s) establishes a bank account in the organization's name with themselves as a signer and simply deposit and withdraw the checks.

- Theft of donated goods – donated goods are just as likely targets of theft as cash. Although it may be more difficult for the perpetrator to carry the goods out, most organizations have poor controls or recordkeeping over donated items which facilitate this fraudulent activity.

Purchasing and cash payment schemes

- Credit card abuse – perpetrators either use organization issued cards for personal benefit, or more damaging for the organization is the use of credit card numbers of donors.

- Fictitious vendor schemes – perpetrators set up a company and submit fictitious invoices to the organization for payment.

Payroll and employee expense reporting schemes

- Fictitious employees – where either terminated employees are not removed from the payroll system, or fake employees are set up in payroll. Payroll checks are issued for non-existent employees and the checks are cashed by the perpetrator.

- Overstatement of hours worked.

- Fictitious expenditures – submission of fictitious expenditures for reimbursement has become a significant problem with the evolution of desktop publishing. The difficulty involved in producing a false invoice for reimbursement has become insignificant.

Other asset misappropriations

- Property and equipment schemes – outright theft of these asset items.

- Personal use of organization's assets and other resources – use of the not-for-profit organization's computers, software, and printers, etc for personal projects.

- Personal long-distance phone calls. Utilizing the not-for-profit organization's internet access and e-mail for personal matters. Photocopying personal documents on the organization's copy machine.

Fraudulent financial reporting:

Fraudulent financial reporting involves false representations relating to financial statements, false statements regarding compliance with requirements of funding sources, charging of unallowable costs to grants and other false statements to governmental agencies. Fraudulent financial reporting is most often committed by management and includes such misrepresentations as:

- Failure to disclose significant related party transactions.
- Failure to disclose noncompliance with debt requirements.
- Misclassifying restricted donations to mislead donors.
- Holding records open beyond the period end in order to inflate revenues.
- Misclassifying expenses to mislead donors and others regarding the funds used for programs.
- Failure to properly value receivables, inventory, donated assets, and liabilities.
- Failure to report trade payables in the correct period in order to understate expenses.
- Failure to properly report obligations for deferred compensation or retirement benefits.
- Misrepresenting the level of a charitable contribution deduction to which a contributor should be entitled to, such as in some car donation programs.
- Non-compliance with donor-imposed restrictions relating to the use of a donation.
- Additional fraudulent practices by not-for-profit organizations may include knowingly failing to comply with Internal Revenue service requirements related to housing allowances or compensation reporting, knowingly misclassifying employees or using them as volunteers to avoid paying overtime, or using or selling donor data collected under false pretenses.

While not as frequent as internal frauds, external frauds can take place in not-for-profit organizations and be just as detrimental. Common external fraud situations include:

- Fraudulent billings by vendors – charging for goods or services not provided or inflating prices, adding phony extra charges.
- Fraud committed by outsourced organizations using funds for other purposes, charging for false transactions, receiving kickbacks from other vendors for subcontracting services.
- Fraud by sub recipients – reporting fraudulent data or program costs to the not-for-profit that provided the award from the original grant.
- Financial assistance fraud – students who falsely receive financial aid or others who fraudulently apply for or use grant funds.

Controlling Fraud

Fraud is a significant potential risk for the not-for-profit organization. The American Institute of Certified Public Accountants and a consortium of professional associations issued Management Antifraud Programs and Controls, Guidance to Help Prevent and Detect Fraud. The report indicates that certain organizations have significantly reduced levels of misappropriation of assets and are less susceptible to fraudulent reporting than other organizations as a result of proactive steps to prevent or detect fraud. Only organizations that seriously consider fraud risks and take proactive steps to create the climate to reduce its occurrence have success in preventing fraud. The foundation for fraud control rests on an antifraud policy set by the board of directors. An antifraud policy set should normally includes a combination of various antifraud controls such as those shown in figure 4.

Figure 4: Frequency of Anti-Fraud Controls --- United States

Control	Percent of Cases
Code of Conduct	74.6%
External Audit of Financial Statements	74.2%
Employee Support Programs	66.0%
Management Certification of Financial Statements	64.1%
Internal Audit Department	61.4%
External Audit of Internal Controls over Financial Reporting	59.8%
Management Review	57.3%
Hotline	54.5%
Independent Audit Committee	53.8%
Fraud Training for Managers/Executives	50.5%
Fraud Training for Employees	49.3%
Anti-Fraud Policy	45.2%
Formal Fraud Risk Assessments	36.5%
Dedicated Fraud Department, Function, or Team	36.4%
Proactive Data Monitoring/Analysis	35.5%
Surprise Audits	31.8%
Job Rotation/Mandatory Vacation	16.1%
Rewards for Whistleblowers	12.7%

Source: 2016 ACFE Report to the Nations on Occupational Fraud and Abuse

Setting the tone at the top

It is essential for management, including directors and officers to "set the tone at the top" for ethical behavior in the not-for-profit organization. Management needs to demonstrate to employees through its words and actions that dishonest or unethical behavior is unacceptable, even when the result of the action may benefit the organization. In addition, it must be clear that all employees will be treated equally in this matter, regardless of their position.

Assessing fraud risks and responses

Not-for-profit organizations must be proactive in minimizing fraud opportunities by (1) identifying and measuring fraud risks, (2) taking steps to mitigate identified risks, and (3) implementing and monitoring appropriate preventative and detective internal controls and other deterrent measures.

Financial/Non-financial systems and controls

Management must establish both financial and non-financial systems and controls for detecting and preventing fraud.

Among the financial controls that management can implement are:

- Accounts reconciliation – reconcile all bank accounts and fundraising assets such as raffle tickets and cash receipts. A person not involved in authorizing transactions or having custody of the assets should perform the reconciliations.
- Perform ratio analysis – comparing number of donors with contributions, comparing number of employees with payroll expense.
- Reviewing all general ledger adjustments.
- Instituting job rotation and mandatory vacations.
- Conducting surprise audits.

The not-for-profit organization must also consider applying non-financial controls, including:

- Pre-screening of potential employees.
- Communicating with employees and being aware of when they are feeling pressured.
- Communicating the consequences of committing fraud.
- Setting a good example by following the rules at all times.
- Providing a hotline.
- Conducting anti-fraud training for managers and employees.
- Implementing an anti-fraud policy.

An Antifraud Team Effort

To effectively address the topic of fraud, the not-for-profit organization needs to consider the efforts of a team potentially comprised of an audit committee, internal and external auditors, etc.

Audit Committee

An audit committee should be established by the board. The audit committee's antifraud role is one of both oversight and participation. The audit committee must at all time challenge management to enforce the antifraud policies of the board. It must regularly assess management's identification of fraud risks and their resulting responses to those risks, including the adequacy of the organization's internal financial control system. It should support and evaluate management's establishment of a culture with a "zero tolerance" for fraud. The audit committee should also evaluate the risk of fraud by management and develop appropriate responses to those risks.

The audit committee's functions should include:

- Remaining alert to signs that might indicate management fraud, including significant changes in life-style.
- Periodically reviewing management travel and other expenses.
- Reviewing unusual and complex financial transactions.

- Periodically reviewing significant nonrecurring journal entries, particularly those near year-end.

- Monitoring compliance with the organization's code of conduct and conflict-of-interest policies.

- Identifying and assessing the appropriateness of all related party relationships and transactions.

- Monitoring the adequacy of the organization's information management system in addition to other physical security measures needed to safeguard the entity from fraud and abuse.

- Verifying that all employees and volunteers are aware that the committee is the point of contact for reporting suspected fraud or abuse and that the "whistleblower" will be protected.

- Investigating all suspected fraud and abuse and communicating appropriate matters to legal counsel and governmental authorities.

- Reviewing the adequacy of insurance coverage relating to fraud and abuse.

- Communicating with external auditors pertaining to the audit committee's assessment of fraud risks, the organization's responses to those risks and any suspected or actual fraud and abuse reported to it.

- Overseeing or performing the internal audit functions.

In performing its duties and responsibilities, the audit committee should document its actions and periodically report to the full board.

Independent External Auditors

The American Institute of Certified Public Accountants has established professional standards providing guidance to auditors in the area of fraud detection in the performance of a normal audit. These standards would require auditors to assess fraud risks, and plan and implement procedures to increase the probability that the auditors will detect significant misappropriation of assets or material misstatements of financial statements resulting from fraud. The external auditors are expected to communicate the following matters to the not-for-profit organization, usually through its audit committee or directly to the Board:

- Unusual accounting methods used or reporting practices applied.

- The basis for estimates found in the organization's financial statements and the reasonableness of such estimates.

- Significant audit adjustments needed to make in order to present the organization's financial statements fairly in all material respects.

- Unrecorded differences found in the audit that were not material to the financial statements.

- Any fraud that was discovered or suspected in the course of the audit.

- Illegal acts or material noncompliance with laws or regulations.

- Weaknesses (known as significant deficiencies) in the design or operation of the organization's internal financial controls that if undetected and corrected could negatively affect the organization's ability to record, process, summarize and report financial information in accordance with the assertions of management.

- Discrepancies with management or difficulties encountered through the audit.

While the responsibility for fraud prevention and detection stays with the board and management, the external auditors can be a significant part of the organization's antifraud team.

Internal Auditor

Studies have determined that nearly two thirds of organizations reported discovery of fraud by internal audit. They further indicate that while an internal audit process doesn't necessarily prevent misappropriation of assets or misrepresentation of financial statements from happening, it does 1) increase the probability of detecting fraud and 2) detect fraud earlier, resulting in smaller losses.

The internal audit process is similar to that of the external independent audit with at least one major difference. The external audit is designed to provide reasonable assurance that the organization's financial statements are free of material misstatement. As a result, the external audit often focuses on larger transactions. However, the internal auditor may examine 100% of the activity in an area. This is what makes the internal audit process highly valuable. The internal auditor can assist the audit committee with many of its tasks.

While funding constraints prevent most not-for-profit organizations from utilizing this antifraud resource, given some useful tools and diligent volunteers almost all organizations can realize the antifraud (and operational) benefits of the internal audit process.

The internal audit process should operate under the direction of and report exclusively to the audit committee so that they can convey any concerns about management's commitment to the organization's code of conduct, management's success in establishing and enforcing strong internal controls as well as report suspicions or allegations of fraud involving senior management.

Certified Fraud Examiner

A certified fraud examiner may assist the audit committee with numerous aspects of the oversight process and/or with the direct fraud investigation. They can provide extensive knowledge and experience and a more objective insight into management's analysis of fraud risk and its implementation of antifraud policies and controls. The certified fraud examiner can also conduct examinations to resolve allegations or suspicions of fraud and act as expert witnesses in any legal proceedings.

Government Agencies

Government agencies also participate in the accountability process. For example, the Internal Revenue Service reviews the annual information returns of many not-for-profit organizations for such things as reasonable relationships between donations and fund-raising costs. When no fund-raising expenses or unusual relationships are found and the organization is determined to be filing inaccurate returns, penalties may be assessed. The threat of economic loss, legal sanctions or discovery of wrongdoing can be a significant deterrent to fraud.

When Fraud is Detected

Fraud can be suspected or discovered by many sources (Figure 5), such as employees, internal auditors, vendors and others. If fraud is detected or there is a reasonable basis to believe that improprieties have occurred, the audit committee should be notified immediately and is responsible for ensuring that an investigation is conducted. As needed, external auditors, internal auditors or certified fraud examiners may need to be engaged to assist the audit committee with the investigation. The audit committee may need to consider the following actions:

- Consult legal counsel on protecting the rights of the accused and ensuring the rights of the organization.
- Notify the organization's insurance company of the suspected or discovered fraud loss as required by the terms of the insurance policy.
- Preserve the documentation or other evidence needed in proving the fraud.
- Repair the breach in internal controls, policies and procedures that made the fraud possible.
- If necessary, inform law enforcement or appropriate government authorities. The appropriate handling of such situations can minimize the harm done to the organization, the people involved and public impact of the experience.

Figure 5: Detection Method by Region --- United States

Detection Method	Percent of Cases
Tip	37.0%
Management Review	14.3%
Internal Audit	14.1%
By Accident	7.2%
Account Reconciliation	6.1%
Other	5.5%
Document Examination	4.8%
External Audit	4.0%
Notified by Law Enforcement	2.5%
Surveillance/Monitoring	1.9%
IT Controls	1.5%
Confession	1.2%

Source: 2016 ACFE Report to the Nations on Occupational Fraud and Abuse

Conclusion

A fundamental responsibility of directors, officers and the management of the not-for-profit are ascertaining that the entity has accountability for its programs and finances to its contributors, members, the general public and government regulators. Accountability subjects the organization to compliance with all applicable laws and ethical standards; conform to the organization's mission; create and follow conflict of interest, ethics, personnel and accounting policies; protect the rights of members; prepare and file its annual financial report with the Internal Revenue Service and appropriate state regulatory authorities and make the report available to all members of the board and any member of the public who requests it.

Whatever their mission or size, all not-for-profit organizations should have policies and procedures established so that assets are managed properly. A failure to meet this obligation can open the door for fraudulent activity which may involve asset misappropriation and/or fraudulent financial reporting. The not-for-profit organization can pursue effectively its anti-fraud efforts by relying on the combined efforts of an audit committee, auditors, etc.

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Association of Fraud Examiners 2016 Report to the Nations on Occupational Fraud and Abuse

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The Coming of China's Hollywood

By Chunji Wu, PhD and
Peng Chan, PhD

Abstract

This study traces the phenomenal growth and development of China's film industry. It undertakes a review of the policies governing the industry and the factors contributing to its impressive growth. The study finds that the industry has succeeded in innovating new genres, embracing policies to promote industrial development, and acquiring new capital and technologies. On the other hand, the study also uncovered policies that constrain industrial development, inherent weaknesses of Chinese cinema chains, and certain unhealthy aspects of the China's film industry. These factors may present challenges to the further development of this industry.

Introduction

China's film industry has finally come of age. While recent attention has focused on the slowing down of China's economy, the growth of its film industry has outpaced traditional industries such as manufacturing. Considered a "sunrise" industry, China's film market is the fastest growing in the world today. Currently, China's movie ticket sales are second only to the U.S. In 2015, China box office revenues hit a record \$6.8 billion, up almost 50% from the previous year, according to the State Administration of Press, Publication, Radio, Film and Television.

It is expected that by 2020, China will overtake North America as the world's largest market for cinema, both in terms of number of movie-goers and revenue, when box office revenues are projected to reach a staggering ￥200 billion (Deloitte, 2016). While the United States has about 100 theaters per million residents, China has only 23 theaters per million. With a population of almost 1.4 billion, that means that China's cinemas have a long way to go before fully reaching its potential audience. On December 20, 2016, China's movies reached 40,917 movie screens; on January 28, 2017, the single-day box office for a Chinese film reached a record of almost￥800 million (Lilei, 2016).

History

China's film industry had its beginnings in the early part of the 20th century. Motion pictures first came to China in 1896. The first Chinese film was made in 1905, but the Chinese film industry did not officially begin until 1913 when Zheng Zhengqiu and Zhang Shichuan shot the first Chinese movie *The Difficult Couple*.

Before the 1930s, films made in China did not make much of an impact due to lack of creativity. Filmmaking developed more quickly in the 1930s and the 1940s, that mainly due to the emerging of a large number of film talents. At that time, Chinese film had entered its' first golden age. China's film industry experienced sustained prosperity after the founding of the

People's Republic of China in 1949, especially for the main stream films. Filmmaking came to a virtual halt during the Cultural Revolution (1966-76). No film was shot from 1966 to 1972. However, the film industry flourished again in the years following the Cultural Revolution.

In the 1980s, China experienced prosperity in its film industry. Led by Xie Jin, the fourth generation of Chinese directors set off a wave of "reflection films" in the early 1980s. Following that, Zhang Yimou and Chen Kaige, the fifth generation of Chinese film directors, led a new wave of Chinese films in the late 1980s. With China's reform and opening-up policy in the late 1970s and its gradual introduction of foreign films, commercial considerations have also made its impact in post-1980s filmmaking. However, due to competition from television, video and other entertainment forms, the Chinese film industry recessed in the early 1990s. In order to stimulate the development of the domestic film market, the government implemented market reforms from 1993 and permitted the showing of foreign movies from 1995 onwards. These reform measures did not have a substantial impact until China's accession to the WTO in 2001. In response to the more intense competition in the international film market, the Chinese government had to introduce more market-oriented reforms in the film industry in 2002. China's film industry has finally entered a stage of rapid development.

With the development of Chinese film art and film industry, many Chinese films have achieved great success in the international market. *Red Sorghum*, *Farewell My Concubine*, *Still Life*, and *Tuya's Marriage* were representative of successful Chinese films from the 1980s to the 2000s. Of course, the global appeal of Chinese films surged after the huge international success of Ang Lee's martial arts flick *Crouching Tiger, Hidden Dragon*, which won the Academy Award for Best Foreign Language Film in 2000. Other successes followed, from movies such as *Hero*, directed by Zhang Yimou.

Rapid Growth

China's film industry has come a long way. By 2010, China's film industry was the world's third largest in terms of number of feature films produced annually. In 2013, China's gross box office was ¥21.8 billion (US$3.6 billion), the second-largest film market in the world by box office receipts. In January 2013, *Lost in Thailand* (2012) became the first Chinese film to reach ¥1 billion at the box office. As of May 2013, 70% of the highest-grossing films in China were domestic productions. About half of all tickets in China were sold online in 2014. From 2014 to 2015, box office revenues increased almost 49%.

During the week of Chinese New Year 2016, the country set a new record for the highest box office grossed during one week in one territory with US$548 million, overtaking the previous record of US$530 million achieved from December 26, 2015 to January 1, 2016 in the United States and Canada combined. The movie "Mermaid", directed by Stephen Chow, set an all-time record of $508 million during the Chinese New Year festival in 2016.

Table 1 presents the impressive growth of China's film industry from 2002-2016

TABLE 1

TABLE 1: THE CHINESE FILM INDUSTRY SINCE 2002					
YEAR	BOX OFFICE(¥,B)	AUDIENCE(M)	FILM PRODUCED	CINEMAS	THEATRES
2002	0.9	N/A	100	1024	1845
2003	0.9	44	140	1045	1953
2004	1.5	56	212	1188	2396
2005	2.0	73	260	1243	2668
2006	2.62	99	330	1326	3034
2007	3.327	114	402	1427	3527
2008	4.341	141	406	1545	4097
2009	6.209	210	456	1687	4728
2010	10.172	290	526	2000	6256
2011	13.115	370	558	2800	9200
2012	17.073	463	745	3680	13118
2013	21.769	613	638	4583	18195
2014	29.639	820	618	5598	23600
2015	44.069	1.26(B)	686	7205	32487
2016	45.712	1.372(B)	772	8817	41179

Source: Data compiled from SARFT, the yearbook of Chinese Film industry, annual reports of China Film Distribution Association, and multiple media reports.

How was all this remarkable growth possible?

Several developments in the film and entertainment industry may provide the answer. These are: first, the concerted government policy to encourage the growth of the culture and entertainment industry; second, the innovation of new movie genres; third, the inexorable growth of the Internet and online services, and, finally, the fresh injections of capital from new investors such as Internet giants (Baidu, Alibaba, Tencent) and real estate developers (Wanda). These new players have used their scale and capital advantages to gradually penetrate the entertainment industry and build an ecosystem.

Government Policy

As we have seen earlier, China's film industry has not always been that rosy. From 1979 to the early 1990s, Chinese movies were mainly propaganda films approved by the Communist government. Consequently, the film market shrunk, with attendance falling by 79% from 1982 to 1991. To revive its movie business, China brought in its first foreign film "The Fugitive" (starring Harrison Ford and Tommy Lee Jones) in 1994. Since then, the Chinese began importing more US films and today allows an annual quota of 34 a year.

As one would expect in a centrally planned economy, the Chinese government plays a crucial role in the growth and development of the film and entertainment industry. Perhaps the most significant action taken by the government is the introduction of the Film Industry Promotion Law of People's Republic of China (FIPL), which became law on November 7, 2016, and will take effect on March 1, 2017. It is the first legislation for the film industry in China and contains many provisions that are important to the development of the industry.

Below are some that merit special attention.

- The new law stipulates that the government at all levels should be united in allowing open and fair competition in the film market through the formulation of appropriate industrial policies. It establishes the fundamental principle of developing China's film market economy, which is in line with the spirit of the Third Plenary Session of the 18th Central Committee. The market economy shall be allowed to play a fundamental and decisive role in resource allocation in the film industry;
- Investments in the film industry would be increased through special funds obtained from cultural industries, use of tax incentives, support from financial institutions, overseas promotion efforts, etc.
- The development of the film industry would be decentralized to the local governments and county-level administrative units. This requires governments at all levels to integrate the development of the film industry into their economic and social development planning, so that the industry becomes an important sector of the national economy;
- Specific punitive measures would be meted out to illegal activities like piracy, theft of box office, false box office, corruption and so on;
- Censorship would be decentralized by the establishment of local groups of accreditation experts. Although the policy toward such decentralization is not new, the implementation of this policy would be different from the past.

Overall, the new promotion law will play a significant role in the development of China’s film industry. However, this promotion law still has some troubling aspects:

- Censorship is still an important provision of the FIPL to help the government maintain its control over the film industry. Although the film censorship system has eased in recent years, and the bill provides for the standardization of censorship, the existence of this system has always stifled independence and creativity, ultimately affecting the entire industry’s ability to innovate and reduce the uncertainty of film investment
- The law clearly lays down the provisions of industrial promotion. However, it does not involve or deal with film culture cultivation and film art innovation, which are more basic to the development of the industry.

In a sense, the Chinese film industry resembles a semi-market economy in which the government is directly involved in its management. Government involvement may not always be a bad thing, especially when the industry’s grew from $100 million to over $6 billion. Obviously, the policies and the management of the State Administration of Film had a vital role to play in the industry’s rapid growth. However, as Michael Porter said in

"The Competitive Advantage Nations", even the best civil servants cannot replace the businessperson in making decisions for the industry. Issues such as censorship, absence of a rating system and unfair market competition still cloud the industry. How to coordinate the relationship between government management and market development will remain an important issue for the development of China's film industry.

Innovation of New Genres

Besides the concerted effort of the government, the growth of China's movie industry in recent years was also aided by the creation of new genres. Some examples are provided in Table 2.

TABLE 2

Genre	Film Title
Youth genre	So Young, American Dreams in China
Comedy	Breakup Buddies; Lost in Hong Kong; A Hero or Not; Goodbye Mr. Loser
Animation	One Hundred Thousand Bad Jokes; Monkey King: Hero Is Back, Kung Fu Panda 3
Main Stream Film	The Taking of Tiger Mountain; Wolf Warrior; Operation Mekong
Adventure Genre	Time Raiders; The Ghouls
Kung Fu Genre	Monster Hunt
Fantasy Genre	The Mermaid
Magical Fantasy film	Journey to the West: Conquering the Demons; Journey to the West: The Demons Strike Back; The Monkey King; The Monkey King 2
Literary film	Mr. Six; Deep in the Heart

Overall, the creation of new genres has helped broaden the audience base, resulting in an increase in domestic box office revenues. Chinese films accounted for 61.48% of ticket sales in 2015, up from 54% the year before.

International Expansion & Partnerships

In 2015, China signed film co-production agreements with 13 countries, as more Chinese films were released into the world film market (Entgroup, 2016). Beginning with Wanda's purchase of AMC in May 2012, the Chinese film industry saw a period of international market expansion and mergers and acquisitions. Wanda, owned by the richest man in China, was undoubtedly leading this movement. In June 2015, Wanda acquired Hoyts Group which was the second largest cinema line operator in Australia. Wanda then used AMC to buy out US-based Starplex Cinemas for $ 127 million in December. In January 2016, a month later, AMC acquired Carmike, the fourth largest cinema operator in the United States, making itself the nation's largest cinema line. In July, AMC announced a £ 921 million formal acquisition of the largest European cinema chain – Odeon & UCI cinemas. With all these acquisitions via AMC, Wanda has become the world's largest movie theater operator. To acquire content, Wanda bought out Legendary Entertainment for $3.5 billion in January 2016. In July, Wanda intended to acquire a 49% stake of Paramount Pictures, but the transaction failed. In November, Wanda announced a $1 billion acquisition of Dick Clark Productions, making it the first time the company owned a TV content property. Table 3 shows Wanda's aggressive expansion strategy into the global film market.

TABLE 3

Wanda Film Group		
Year	**Cinema Chains**	**Studios**
2005	Wanda	
2011		Wanda Pictures
2012	AMC (2nd in USA)	
2015	Hoyts (2nd in Australia) Starplex Cinemas (USA)	
2016	Carmike (4th in USA) Odeon & UCI (1st in EU)	Legendary Entertainment Failed in acquisition of Paramount

Other Chinese companies soon followed Wanda's footsteps. LETV concluded 12 film cooperation agreements with Hollywood; Hunan TV & Broadcast entered into a $1.5 billion agreement with Lionsgate to co-produce 14 films in the next three years; while Bona Pictures pumped $ 235 million into TSG Entertainment Finance in the US, which then signed an agreement with 20th Century Fox to give Bona Pictures the right to receive a proportionate share of the global box office on a project. Finally, Huayi Brothers co-invested with STX Entertainment in the US, to produce at least 18 films by the end of 2017 (Entgroup, 2016). In addition to expansion into the US, Chinese film companies also aggressively entered the South Korea market via 28 mergers and acquisitions with a total outlay of $1.31 billion in the first three quarters of 2015.

Role of Internet

China's film industry has not only entered the era of golden capital, but the age of the Internet as well. The rapid growth and attractiveness of the film industry have not only attracted huge investments from traditional investors but also caught the attention of the giant e-commerce companies. Armed with tremendous financial resources, successful internet and e-commerce companies like Alibaba, Baidu and Tencent have jumped into the explosive film industry. On

July 2016, Alibaba Group announced to set up a target of ￥2 billion cultural industry fund, to begin a bigger play on the film and entertainment industry.

In late 2013 Tencent launched the "WeChat movie ticket" service. In June 2014, the company announced its investment in 6 films such as in "Zhongkui: Snow Girl". iQiYi, the video website of Baidu, established a film company in July 2014 to co-produce with many domestic and foreign film companies. Tencent established Penguin Pictures in September 2015 to focus on internet TV series, film investment and artist agency. Youku Tudou invested in films since 2013, established Heyi Pictures in August 2014, and co-produced films like "Monster Hunt", "Forever Young", and "The Taking of Tiger Mountain". Alibaba launched the ticketing platform "Taobao movie" in 2013 and released "Yulebao fund" in March 2014 which generated nationwide enthusiasm for film investment. In June, Alibaba acquired 60% stock of "Chinavision Media Group", renamed it to Alibaba Pictures, and gradually integrated the "Yulebao fund" and "Taobao movie" into the picture company. The three giant e-commerce companies, Tencent, Baidu, Alibaba, have now fully integrated online ticket agencies. These agencies contributed 40% of ¥29.6 billion Chinese box office in 2014, an increase of 60% compared to 2013 (Gao et al, 2016).

With the development of the Internet, new video art formats like micro-movie, movie and TV series for internet network were born. Together with cinema, the industry chain represents a ladder-like growth path for young filmmakers. Meanwhile, the Internet has greatly expanded the territory of China's film industry. With the growth of Chinese population in the US, even American movie-streaming giants such as Netflix and Amazon have acquired the distribution rights of many Chinese movies for its US viewers.

Conclusion

Despite its rapid growth, the Chinese film industry still faces some nagging issues that industry experts say must be resolved before it moves on to the next level of development. For example, censorship, absence of rating system, a chaotic pricing system, piracy and inadequacies in intellectual property right protection have continued to cloud the industry. Furthermore, there is a lack of a formal channel for closer communication between filmmakers and investors, which has blocked the flow of investment money into the industry.

In spite of these issues, China's film and entertainment industry is expected to continue to grow rapidly in the next 5 years. Mainstream forms of entertainment such as TV, film, and online videos will continue to prosper; rivalry between industry stalwarts and new entrants will become fiercer; international alliances will grow; cross-industry cooperation and competition will continue, and we shall see a re-shuffling of the industry chain.

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Exporting as a Key Growth Venue for Small Business: Venturing Abroad to Gain Market and Profit

By Elizabeth Glynn, M.I.M., CGBP

Abstract

As the U.S. market matures, the business environment has become more competitive and price driven. To increase access to new customers and to increase sales growth and profit small businesses are seeking new venues of business opportunity. Increasingly, businesses are motivated to pursue customers in global markets and expand sales growth by exporting. This article will highlight some of the elements that businesses should consider as they position to compete effectively in global markets, including why commitment and preparation are critical, and steps for how businesses can expand to capitalize on the diversity of global sales opportunities that are expected to expand in emerging economies through 2020.

Introduction

Today, more than ever, companies are increasing sales growth not only in the Unites States (U.S.) but also across a multitude of countries. In the U.S. quality is good and products are readily available; however, while the market is mature, competition can be brutal, and it is fiercely price competitive. There is likely greater opportunity to increase sales growth by selling products and services in global markets. With innovative or unique products businesses can, and should, consider expanding beyond the U.S. Companies solely focused on business growth in the U.S. will find expansion is limited. For companies challenged to expand in the U.S., a better option is to pursue sales growth in the vast global marketplace.

Consider the following facts:

- The United States represents 5% of the world's consumer market
- 95% of the world's consumer market resides outside the U.S.
- About two-thirds of the world's purchasing power lies beyond the U.S.

Remarkably, the United States benefits from the fact that the quality and value of its manufactured products are well regarded throughout much of the world. Products manufactured in California garner even greater interest. Given this recognition, it is surprising that not more U.S. small- and medium-sized businesses, especially manufacturers, capitalize on exporting more broadly across global markets.

The Economy in California[1]

In California manufacturing helps to drive the economy. In 2015 California exported $143.87 billion in manufactured goods. Of this figure, $60.56 billion in goods were exported to Free Trade Agreement (FTA) Partner countries, including Australia, Bahrain, Canada, Chile, Columbia, Costa Rica, Dominican Republic, El Salvador, Guatemala, Honduras, Israel, Jordan, Mexico, Morocco, Nicaragua, Oman, Panama, Peru, Singapore, and South Korea.

Top 5 export markets include

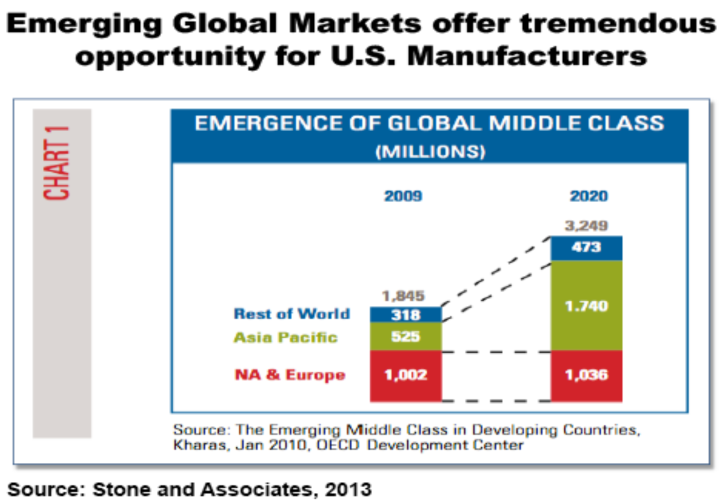
- Mexico (17.8%)
- Canada (9.8%)
- China (8.0%)
- Japan (7.2%)
- Hong Kong (5.3%)

According to U.S. Census, in 2016 California's total exports were $163.616 billion, and represented 11.2% of U.S. total exports.[2]

Exports from California include but are not limited to food products, cosmetics, aircraft parts, computer components, medical devices, automobile parts and accessories, and much more. Many products are exported by small businesses. It is estimated that 96% of these companies export to some degree. Often, companies export in response to overseas buyers' demands on an ad hoc basis. They are not responding in a proactive manner nor have they integrated exporting as part of their business plan. For a good number of companies, they simply have not recognized this potential business prospect.

Unfortunately, not enough California businesses are taking advantage of the significant global exporting opportunities that are growing even more due to emerging market economies. See Figure 1.

Figure 1: Emerging Global Markets[3]



Why More US Firms Are Not Exporting

Some of the reasons why US small businesses do not exploit global business opportunities include the lack of awareness, a belief that global business is too complex, and simply fear of the unknown. For many it is the lack of knowledge as to how to move forward into the global markets that is a key roadblock. In actuality, it is not as complex as it seems. Yes, it does take time, and there is much to do before venturing overseas. However, there is an abundance of export resources available, including a well developed global trade network in Southern California that is on hand to assist companies that want to move forward with export expansion.

How Foreign Companies Leverage U.S. Capabilities

U.S. manufacturers profit from world class capabilities. Quality in the United States is well regarded. The "*Made in USA*" label is valued throughout much of the world. And, the "*Made in California*" label garners added interest. Given the visibility of entertainment, innovation, aerospace, technology, and tourism – to name but a few key sectors – the "*Made in California*" quality and label should be highlighted when selling across global markets. Overseas buyers are keenly aware that goods produced in California meet high quality standards.

Compared to Germany, for example, U.S. labor costs are more economical and productivity rates are higher. This is a competitive advantage that many

U.S. manufacturers have not leveraged. Consider the following: if you were asked to identify the leading U.S. auto exporter by value in 2015, which auto multinational would you name? Perhaps you would say Ford or General Motors. Perhaps you would name Toyota or Honda. In either case, you would be incorrect. In fact it is BMW. In an article posted on IndustryWeek.com on February 20, 2016,

> *BMW Manufacturing Co. announced today that the export value of its passenger vehicles through the Port of Charleston in 2015 totaled $9.8 billion, confirming the company's South Carolina facility as* ***the leading U.S. automotive exporter by value****.*[4]

BMW established production in the United States primarily to serve the large U.S. market. Additionally, BMW exports the X3, X4, X5, and X6 models produced in the United States to 140+ global markets.[4]

By manufacturing in the United States, BMW is able to take advantage of: 1) competitive U.S. labor rates; 2) higher U.S. labor productivity, as well as 3) minimize tariff and transportation costs of exporting vehicles from Germany to the United States. Not only is BMW manufacturing vehicles for the U.S. market, it is leveraging competitive advantages for which the U.S. is noted. As well, BMW is maximizing its U.S. platform in South Carolina by also exporting U.S.-produced automobiles to overseas markets. U.S. manufacturers would do well to leverage their competitive advantages to expand into and increase sales growth in global markets, where the demand and opportunity exist.

U.S. Businesses are encouraged to leverage their competitive advantage

Rather than fight for greater share in a fiercely competitive local market, an effective strategy would be to expand sales by exporting into global markets that are interested to purchase U.S. goods, machinery, components, and services. It would serve U.S. businesses well to leverage their competitive advantages: unique product and service offerings, quality, innovation, labor benefit, and, the higher labor productivity for which the U.S. is noted. By capitalizing on these competitive elements, along with taking a more proactive approach in responding to export inquiries received either at trade shows or via electronic correspondence, companies can access new customers and expand sales growth thus achieving an essential business priority, augmented sales expansion.

Reasons to Pursue Global Markets

Typically, companies that export tend to be stronger players in their home markets. They are more innovative; they are more flexible; and, they are more attentive to customers' needs. All these elements position them to be stronger competitors – domestically and globally.

For most Companies the motivation to export provides multiple benefits:

1. Access to new customers
2. Expanded sales growth
3. Increased profit

Figure 2: Exporting leads to business growth

As noted previously, the U.S. market is mature, jam-packed with competitors, and intensely price-driven. Rather than invest significant time and effort to increase market share in an already tight market, businesses can more effectively leverage their limited financial and business resources to identify several global markets that value and desire U.S. products and services. An efficient starting point can be smaller global markets. Generally, in smaller markets there is less competition, and it provides an easier path upon which companies can begin to build their export platform.

Businesses are encouraged to recognize and to understand which markets provide superior business opportunity. As well, companies need to understand their capabilities so that they can position themselves in those global markets that can provide greater financial gains. Consequently, it makes sense to take the time to invest in market research and work through the due diligence to determine where keen interest for their products or services are desired.

Developing an Export Strategy

Increasingly, companies are motivated to pursue global markets in order to gain customers and to expand sales. However, it is important that they also ensure that they have the available resources to support development of, and expansion into, the selected global market(s).

To accelerate export sales growth and to minimize risk, businesses are encouraged to develop an export business strategy. In the export strategy the company will want to: 1) select, and adapt as appropriate, key product(s) to be exported; 2) conduct market research so as to identify and select a high growth global market(s) in which to expand; 3) understand how the product(s) will be distributed and positioned in the selected market(s); 4)learn how business is conducted including the nature of the business relationship that will evolve; and 5) be flexible and open to best practice(s) that can support competitive positioning.

Once the company has determined which global market(s) to pursue, it will want to develop its export infrastructure so that it can support the coming business growth. It is not enough to export products to an overseas buyer. Before committing to the first round of export shipments, it is essential to determine which product or products are exportable; identify which market or markets will yield optimum business opportunity; determine if, and how, the product or products will need to be adapted to accommodate local standards; what financing is available to support global business transactions; and, how to deliver these products on a consistent basis to the overseas buyer(s).

Success in global business requires more than interest in entering a new market. While motivation is important, businesses must also have the resources to support export expansion as well as the openness to understand that flexibility and adaptation are often necessary. Expanding and building global market presence takes time, typically 18 months to three (3) years, and should be considered an investment into the future.

Integrate Company Personnel in the Export Process

As there are multiple steps involved, it is important to allow time for understanding and learning the exporting process. This endeavor will require engagement of staff and training to support the Company's export expansion effort. As a result, it will be beneficial to integrate personnel from across the organization including product development, manufacturing, marketing & sales, finance, legal, operations, and so on.

Without commitment from the Executive Team to develop and support the targeted global market(s), it will be difficult to sustain business growth over the long-term. It is for this reason that companies are urged to begin slowly, ideally with one or two markets. It is with ongoing development and subsequent implementation of an export business plan that companies can support more effective acceleration of their export expansion efforts.

Commitment to Global Markets Is Imperative

> *Geographic diversification enables us to operate in multiple regions with different business cycles. For the long term, we are trying to ensure that no one market accounts for more than one third of our business. Yet we do not diversify simply to balance cyclic downturns and upswings.* ***We do not see volatility as an occasional, random element added to the cost of doing business in an international global marketplace. We plan for volatility. We prepare for it. We have learned how to profit from it.*** - Lorenzo Zambrano, CEO, CEMEX[5]

Global business is not for the faint of heart. To mitigate risk and accelerate sales growth and profit, companies are advised to move forward slowly. This said, there is tremendous opportunity for companies willing to invest time to understand which global markets to pursue; and, more importantly, to learn how to position for sales growth and success in the targeted global market(s). To achieve this requires three essential elements: commitment, time, and staff to support not only the relationship that is to be developed but also to ensure that, once interest is established, the company is able to deliver on a consistent basis. In fact this can serve as a key value differentiator between the exporting business and its competitors in the targeted global market(s).

Relationships in global trade are critical to development of global business growth. This cannot be underestimated. In the United States, business can be conducted on a relatively quick basis. In global trade business expands based on the development of relationships that can result in enduring and consistent partnerships over many years. Those companies that learn how business is conducted locally as well as take the time to develop a business relationship with the overseas buyer(s) will find that sales growth will develop more readily.

Moving forward

Small- and medium-sized businesses are encouraged to export their products and services across global markets. They have competitive products and services that they have yet to introduce in the global marketplace. In many regions, especially throughout the Asia Pacific, Latin America, and Africa, there is mounting investment in infrastructure. As well, there is an emerging group of global consumers with more access to disposable income and interest to purchase products and services that can enhance their lives. As these emerging economies evolve, there will be more consumers interested to purchase goods and services that provide comfort or evoke status. However the interest evolves, there will be business opportunity for those companies ready to respond to global consumers' needs.

Capitalizing on Demand for U.S. Products and Services

U.S. businesses are encouraged to take action while interest in U.S. products and services remains strong. If not, emerging competitors will step up to fill the gap. As noted at the beginning of this article, there are several reasons to pursue sales growth in global markets: access to new customers, expanded sales growth, and increased profit.

Bear in mind that there are more than 100 global markets with buyers and consumers eager to purchase U.S. goods and services. Companies need only begin with one (if new-to-export), maybe two or three global markets. As they gain expertise and ease with exporting, and create the infrastructure that will support growing global sales, businesses can move forward with expanding across more global markets and regions.

Summary

In conclusion to accelerate export sales growth, small businesses are encouraged to develop an export business strategy that will be integrated in their overall business plan.

In developing an effective export business strategy, businesses should:

1) Identify key product(s) or service(s) to export;
2) Identify key global market(s) interested in their product(s) or service(s);
3) Understand and adapt, as needed, products or services to meet local market preferences;
4) Adapt, as needed, to the localized production requirement(s) of the global market(s);
5) Understand how local business evolves and is conducted in the selected market(s); and,
6) Invest the time, effort, and support to develop enduring business relationship(s) with identified and vetted global business partners.

Buyers from around the world are interested to purchase U.S. products and services. For businesses ready to begin exporting there are a myriad of resources available to help them become export-ready so that they can seize emerging global business opportunities. As well, a dynamic local global trade network in Southern California stands ready to support businesses as they gear up to compete globally. All companies can be assisted – from companies brand new to exporting through those companies eager to take their export expansion efforts to an even greater level.

The global marketplace yields many possibilities for gaining customers, expanding sales, and achieving enhanced profitability. Increasing sales by exporting can be a key growth venue for more U.S. small- and medium-sized businesses, and in particular California manufacturers.

Resources – Export web links

Exporting benefits companies with access to new customers, opportunity to increase sales growth and profit. To learn more about exporting and global trade in California, browse the following resources:

- U.S. portal for exporting, www.export.gov
- State Exports from California
  Top 25 Countries
  https://www.census.gov/foreign-trade/statistics/state/data/ca.html
- Centers for International Trade Development, https://citd.org/
- Export Business Planner, https://www.sba.gov/managing-business/exporting/export-business-planner
- ExporTech™ for Manufacturers (SMMs), www.cmtc.com/exporting, www.exportech.org
- Trade Connect, Port of Los Angeles, http://www.latradeconnect.org/
- World Trade Week calendar, www.worldtradeweek.com
- District Export Council of Southern California, www.decsocal.org
- Foreign Trade Association**,** www.foreigntradeassociation.com/
- Global Initiatives Council, Los Angeles Area Chamber of Commerce
  http://www.lachamber.com/global-initiatives/global-initiatives-council/

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2.) U.S. Census – Export Trade Data (California)
https://www.census.gov/foreign-trade/statistics/state/data/ca.html

3.) Emerging Global Markets / ExporTech™ Michael Stone, Stone & Associates, 2013

4.) BMW Spartanburg Takes Top Spot for US Auto Exports / IndustryWeek / February 20, 2016,
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5.) *The Globalization of CEMEX (*Case 2-2, page 135). Transnational Management: Text, Cases, and Readings in Cross-Border Management, 7th Ed.
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Since 1998 Glynn has taught courses in global business management, leadership, and ethics at the University of La Verne (MBA), and a number of global courses at UCLA Extension, including global logistics and fundamentals of international trade.

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The Importance of Pricing Strategies for Small Firms

By Prof. Han Chen

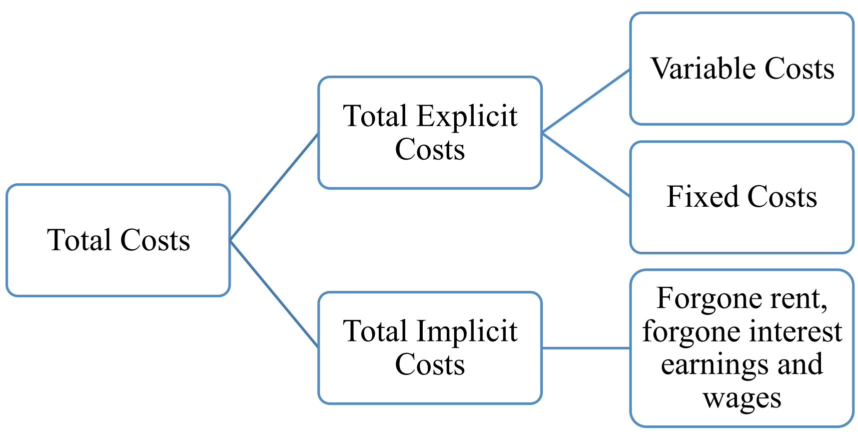
Introduction

Pricing strategies are usually critical determinants of profitability. Price is one of the four Ps of marketing. The other three are product, promotion, and placement. While large corporations are becoming increasingly aware of the importance of pricing and make investment on research teams, pricing decisions are often badly managed by small firms. The goal of this paper is to shed lights on the pricing strategies that small firms can apply.

The rest of the paper is structured as follows. Firstly, the nature of cost is introduced, with a focus on implicit costs that are usually not recognized by small businesses. Secondly, the paper discusses the true measurement of success, with a focus on the difference between accounting profit and economic profit. Lastly, the paper surfaced a couple of pricing strategies, with a focus on price discrimination.

The Nature of Cost

To determine a proper price, business owners should understand the nature of costs of running the businesses. The differentiation between explicit costs and implicit costs are vital to pricing decisions. Figure 1 shows the relationship among various costs.



Full costs (economic costs) = Total implicit costs + total explicit costs;

Total explicit costs = Fixed costs + Variable costs.

Figure 1. The Nature of Costs

Explicit costs are monetary payments for all resources purchased from others, including property and equipment, raw materials, inventory, utilities, financing, salaries, etc. Because these costs involve an obvious cash transaction, they are referred to as explicit costs.

Implicit costs are non-monetary opportunity costs of all resources owned by the business owners. Opportunity costs are the next-best alternative value of the resources if they are used elsewhere other than in the business. For example, if a business owner quit her job that paid a salary of $4000 per month and started her own business, the $4000 salary forgone is the implicit cost of her labor.

Other examples of implicit costs include: forgone rent from properties owned by the business owner, forgone interest earnings from capital owned by the business owner, forgone wages of the business owner that would have earned if worked for other firms. Because these costs are not obvious, they are referred to as implicit costs.

True Measurement of Business Success

The true measure of business success is economic profit, rather than accounting profit. We should differentiate between these two profit concepts.

Accounting profit = Revenue – Explicit costs

Economic profit = Revenue – Explicit costs – Implicit costs

Figure 2 shows the relationship among various costs and profit concepts. By subtracting all of the economic costs from the revenue, a business owner is able to compare the performance of the current business and the best alternative business venture. If a business is making an accounting profit but an economic loss, the business owner should switch to the best alternative venture. If a business is making an economic profit, the business owner may want to continue or even expand the current business.

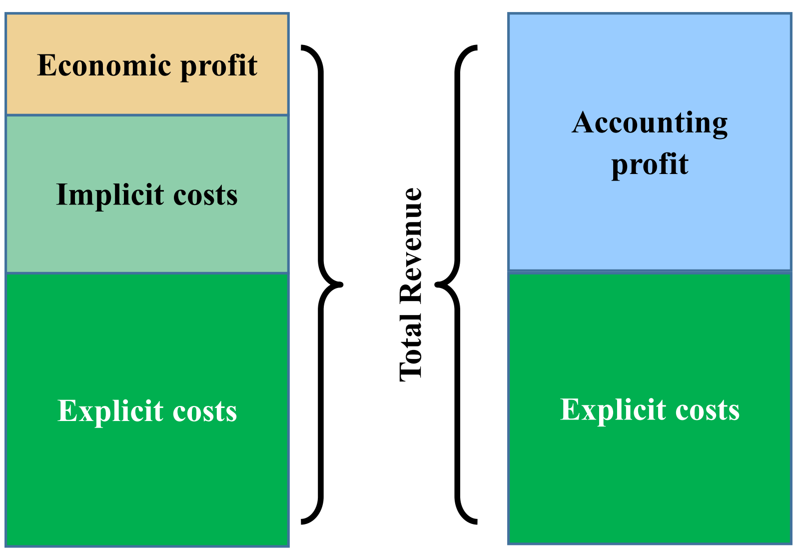


Figure 2. Economic profit versus accounting profit

Economic profit means doing as well as one possibly can – that is, making more money in the current business than one could pursuing any other business venture, or work for other firms. Success is not defined as when total revenue only exceeds total explicit costs. Rather, both explicit and implicit costs should be taken into account.

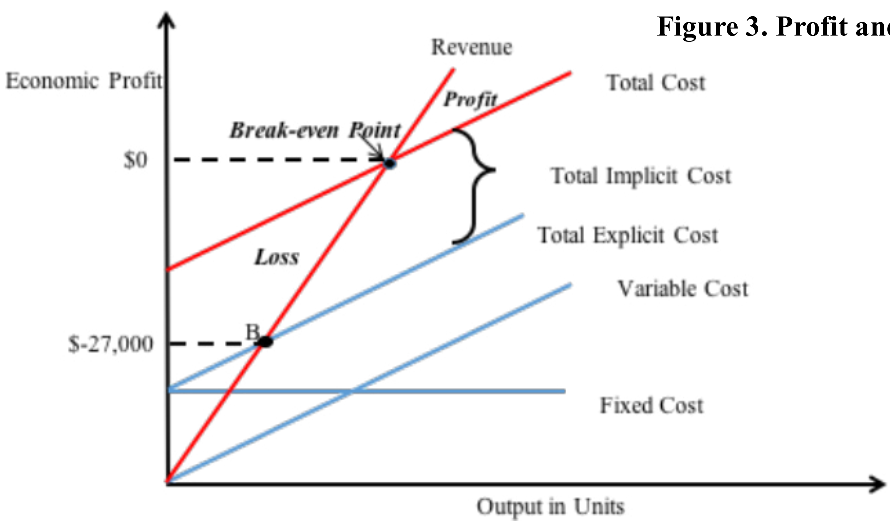
A business is sustainable only if it is making economic profit, rather than accounting profit. A business may win a bid through a low price, but it is not sustainable in the long run. Only when revenue is greater than the sum of explicit cost and implicit cost can a business be sustainable. One of the common mistakes small businesses make is underestimating full costs, more specifically, ignoring implicit costs. When business owners think their businesses are breaking even they are actually making a loss. It is important to emphasize the definition of the break-even point.

The **break-even point** is defined as an output level where revenue is equal to the sum of total explicit cost and total implicit cost. The idea can be better understood with a numeric example similar with the one used in an economics textbook[1]. Suppose one decides to open a T-shirt shop. The revenue and costs of the business are as follows:

Total sales revenue $90,000
    Cost of T-shirts $40,000
    Clerk's salary 18,000
    Utilities 5,000
Total explicit costs 63,000
Accounting profit 27,000
    Forgone interest 1,000
    Forgone rent 5,000
    Forgone wages 21,000
Total implicit costs 27,000
Economic profit 0

Without taking into account the implicit costs the business appears to be making an accounting profit of $27,000, but after including implicit costs the business just breaks even – making zero economic profit. In Figure 3 below, the distance between total costs and total explicit costs is total implicit costs. At point B, where revenue just covers explicit costs the business is suffers an economic loss of $27,000.

Figure 3. Profit and Implicit Costs



[1] McConnell, C.R., Brue, s.L., and Flynn, S.M. (2015). *Economics* (20th ed.) (pp. 197-199). New York, NY: McGraw-Hill Education

Pricing Strategies

After acknowledging the importance of implicit cost and the concept of economic profit, the next step is to apply different pricing strategies to maximize profit.

Cost-plus Pricing. Using the cost-plus method, the price is determined by adding some standard margin on top of the total costs, regardless of competition and consumers' valuation on the products. This is perhaps one of the oldest and still is the most common approach. There are several drawbacks: first, the standard margin is highly subjective. For example, a common standard margin in the restaurant industry is "food is marked up three times direct costs, beer four times, and liquor six times.[2]" Second, it totally ignores the consumer side and the competitors' strategy.

Skim Pricing. Using this strategy, the business attempts to sell a product at a high price. This strategy can be used when: the product is new to the market and there is little competition; demand is fixed and the customers are not too price-sensitive.

Penetration Pricing. Using this strategy, the business attempts to sell a product at a low price. This strategy can be used when: the competition is intense; customers are very price-sensitive.

Value-based Pricing: Price Differentiation. This approach is based on the consumers' valuation. It means that firms charge different prices based on each consumers' valuation for the same product. For example, Early-booked flight tickets are usually less expensive than later-booked tickets, because leisure travelers who usually book early are more sensitive to prices than are business travelers who tend to book later. The key for price differentiation is market segmentation, the process of dividing an entire market up into different customer segments, in order to charge different prices. The rest of the paper discusses some tactics for price differentiation.

Tactics for Price Differentiation

Group Pricing. Group pricing is the tactic of offering different prices to different groups of customers. Examples include: student discounts, senior citizen discounts, "lady's night" specials, etc. This pricing strategy charges a lower price for certain groups who would not have purchased the product at the regular price. By charging a lower price the firms may drive up their market share.

Channel Pricing. Channel pricing is the practice of selling the same product for different prices through different distribution channels. Examples include: "web-only" sales, lower price via mail-order catalogs, higher price at airports, sales at outlets in remote areas, etc. One of the reasons for the channel price strategy is that it is less costly to sell on-line, through mail-order catalogs, or at remote areas, and more costly to sell at airports. Another reason is that consumers at airports are less sensitive to price, whereas consumers shopping online or at remote areas are more sensitive to price.

Couponing. Examples of couponing include: coupons through newspapers, direct mail, and magazines, mail-in rebates, coupons on various websites, etc. Couponing is a good way for market segmentation. Coupons are available to all consumers, but only those who are sensitive to price are willing to take the time and effort to find the coupons.

[2] Cited in Godin and Conley (1987, p.58).

There are other tactics for price differentiation, such as time-based differentiation (movie tickets are cheaper for a weekday matinee than for a weekend night show), volume discounts (buy more to save more), product lines (Basic Edition of a software is less expensive than the Premier Edition even though the costs are similar), and so on.

Conclusion

Pricing is an important component of profit maximization. It has made remarkable contribution in many industries. While large corporations can afford the human resource and software for the quantitative sophistication, small firms can also benefit by recognizing the importance of implicit costs, the concept of economic profit, and utilizing different pricing strategies. Moving forward, research could explore more solutions to help small firms enhance revenue and strive towards stronger performance.

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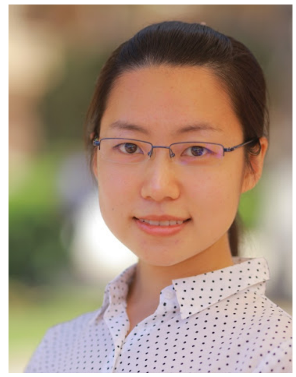
ABOUT THE AUTHOR



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The Rise of Drones

By Will Smith, PhD and
Peng Chan, PhD

Abstract

This study seeks to examine the rapid growth of the drone industry and its implications for businesses. Drones, officially called unmanned air vehicles (UAVs), are expected to drive substantial economic impact and disruption by 2025. No longer are drones for the hobbyist. UAVs have found applications in various industrial verticals which include military, homeland security, agriculture, and retail. While demand is significantly higher for military applications, commercial applications are gradually catching up.

Introduction

The Internet, connectivity, social media, and the massive amounts of data generated contribute to technology all of which shape our future as a world society. In as much as advancements in technology vitalities economic growth, these successes at times deliver disruptive change. Over time people have grown accustomed to anxiously awaiting the coming of new technology and to that end have become victims described as the "next new thing" fatigue. Joined with this anticipation is tremendous noise from businesses that creates enormous challenges in determining which technologies in actual fact matter.

This research report has identified and focused on one such technology that has great potential to drive substantial economic impact and disruption by 2025. Drones were selected because the technology met four shared characteristics: high rate of technology change; broad potential scope of impact; large economic value that could be affected; and substantial potential for disruptive economic impact (Manyika et al, 2017). Drones were further selected for this study because the technology fell within one or more of the twelve potentially economically disruptive technologies classified by the McKinsey Global Institute, which is part of McKinsey & Company (Manyika et al, 2017). Figure 1 shows the twelve disruptive technologies and where drones fall within the classification.

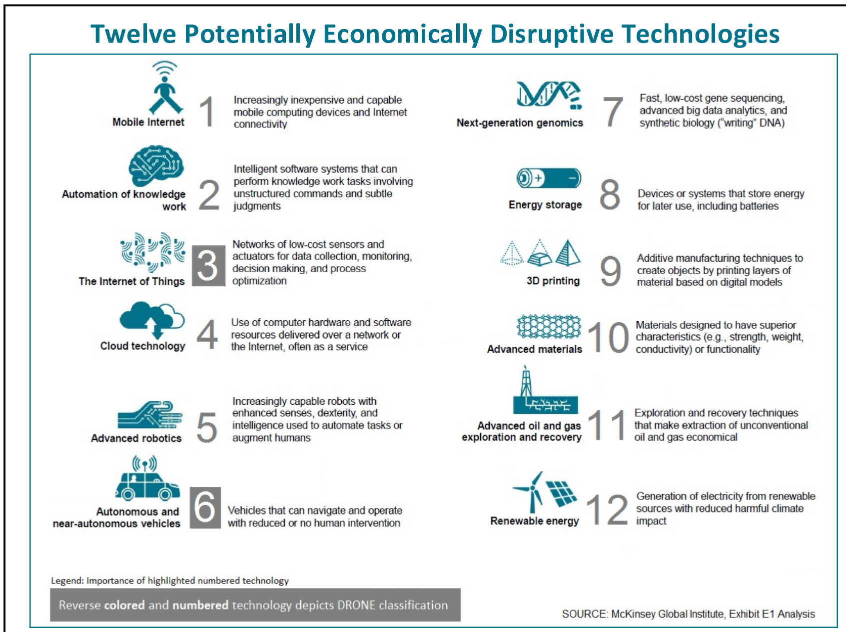

FIGURE 1

The drone industry is big news these days. Early estimates from the Federal Aviation Administration predicted 600,000 commercial drone aircraft operating in the United States in 2016. The Teal Group, an aerospace and defense research firm identified five industries that will be employing drones in their operations. Their early forecast shows small commercial unmanned aircraft systems (UAS) to reach 2.7 million device units by 2020. While the rapid growth of the drone industry in the short term has outpaced the development of rules and systems to govern their use, regulatory clarity is on the horizon. The industry is beginning to accelerate the evolution and uniting technology with drone big data management apps, and in doing so, drones are emerging as the new platform driving greater data flows all of which will demand accelerated computing power. Increased drone use will skyrocket data collection at unprecedented rates beyond the stratosphere of zettabytes. This technology is an opportunity for greater efficiency and cost reduction of yet unknown proportions. This avalanche of incoming data requiring in-depth analytics will usher in the complete dependence on predictive intelligent machines.

Background

On June 8, 2014, history was made in the United States when the U.S. Department of Transportation's Federal Aviation Administration (FAA) gave approval to energy corporation BP and unmanned aircraft systems (UAS) manufacturer AeroVironment to fly an AeroVironment Puma AE for aerial surveys in Alaska (Federal Aviation Administration, 2014). This event is important, not because it was the first time a commercial UAS was authorized to fly over land, but it signaled an important step toward the broader commercial use of unmanned aircraft.

The FAA leveraged, under Section 333 of the FAA Modernization and Reform Act of 2012 (FMRA), its authority to grant case-by-case authorization for certain unmanned aircraft to perform commercial operations before finalizing the formal Small UAS Rule. Today 5,551 "Section 333" petitions have been awarded by the FAA as of September 28, 2016 (Federal Aviation Administration, 2017).

Since the first drone flight over land in June 2014, the FAA had only approved 120 "Section 333" exemptions for UAV use, including 22 for agricultural purposes (Metzer, 2015). A rapid increase in commercial drone flight approval soon followed, and by March 16, 2016, more than 4,000 exemptions generating a Certificate of Authorization or Waiver (COA) had been granted (Federal Aviation Administration, 2015).

Adjoining the escalation of COAs the FAA on December 14, 2015, issued a rule requiring all UAS weighing more than 0.55 pounds (250 grams) and less than 55 pounds to be registered using an online system. The objective of this ruling that targeted model aircraft and hobbyist was to identify owners and gather data about UAS use. Three (3) months later—March 2016—more than 408,000 registrations had been processed online (Federal Aviation Administration, 2015). From this preliminary UAS registration data, the FAA was not only able to forecast device sales to hobbyist but extrapolate potential sales for commercial UAS use nonmodel aircraft. The first forecast for the 2016-2020 period revealed that hobbyist unit device sales could increase from 1.9 million to 4.3 million with commercial nonmodel aircraft sales reaching 2.7 million device units. Figure 2 depicts the unit device sales forecast put forward by the FAA.

FIGURE 2

Drone Device
Sales Forecast Summary
Million sUAS Units

Aerospace Fiscal Years	2016	2017	2018	2019	2020
Hobbyist (model aircraft)	1.9	2.3	2.9	3.5	4.3
Commercial (non-model aircraft)	0.6	2.5	2.6	2.6	2.7
Total	**2.5**	**4.8**	**5.5**	**6.1**	**7.0**

Note: Numbers may not add due to rounding

Source: Federal Aviation Administration
Aerospace Forecasts Fiscal Years 2016-2036

Drones Move Forward

Envisioning the monumental and rapid growth of the UAS market, the FAA sped up regulatory efforts to safeguard the national airspace system (NAS) starting with the issuance of the Operation and Certification of Small Unmanned Aircraft Systems Notice of Proposed Rulemaking (NPRM). Acting on this notice the Teal Group Corporation, an aerospace and defense industry research firm was engaged in developing an economic forecast for small UAS operations as described in the NPRM. The engagement brought forth a more in-depth identification and categorization of small UAS (sUAS) as either higher-end sUAS with an average unit device sales price of $40,000 or lower-end sUAS averaging a $2,500 unit device selling price. While the information was educational the more disquieting number was the 542,500 sUAS fleet total.

With sUAS rulemaking under way America was informed by the then Federal Aviation Administration Administrator Michael Huerta, during a news conference at Newark Liberty International Airport in Newark, NJ, that early estimates predicted 600,000 commercial drone aircraft operating in the US in 2016. What started with a single drone flight in the far reaches of Alaska in 2014, more than 2.5 million drone devices—hobbyist and commercial—will quickly occupy America's national airspace.

Disruptive Impact

The beginnings of the early Teal Group analysis identified the five most compelling industries that would be employing sUAS routinely in their operations. These sectors were industrial inspection at 42% market share, agriculture 19%, insurance 15%, real estate/aerial photography 22%, and government agencies at 2%. Figure 3 depicts the industries put forward by the Teal Group

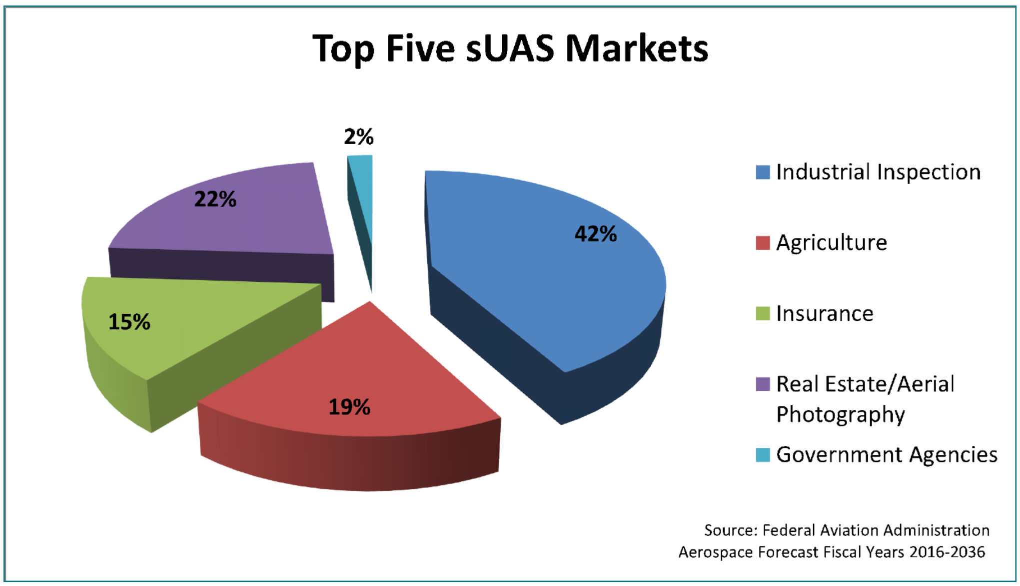

FIGURE 3

The unwavering surge of this technology compelled the FAA to look beyond present day regulatory initiatives, which shepherd in the development of the UAS Focus Area Pathfinders initiative. The prime directive of this program sought to explore how UAS could be operated in populated areas and beyond the pilot's direct line of sight in rural areas. With a view to expanding UAS commercial flight operations, CNN seized the moment to start research on visual line of sight flight in urban populated areas for news gathering. In an alternate path offering less resistance—rural areas—BNSF Railroad immediately partnered with the FAA to test drones for remote track and bridge inspection and air quality monitoring (Federal Aviation Administration, 2016).

Rail inspection, the practice of examining rail tracks for flaws, is of utmost importance. According to the United States Federal Railroad Administration Office of Safety Analysis, track defects are the second leading cause of accidents on railways in the United States. What started as visual inspections soon grew to utilize massive rail inspection cars and HiRail trucks to inspect BNSF's more than 32,500 miles of U.S. rail line. BNSF reports that every foot of track is personally inspected twice a week and that a significant portion of the track is hundreds of miles from any major population center thereby ever-increasing expenses.

In comes drone technology taking forward BNSF's capabilities to conduct far more frequent inspections rather than expanding inspection crews or human capital (Morris, 2015). Drone-based inspections present a tremendous opportunity and the potential for greater labor efficiency. Rail track inspection in these remote rural areas is demanding and invites challenges with disagreeable insects, toxic vegetation, and poisonous snakes. The Bureau of Labor Statistics (BLS) reports that railroad workers as a collective fatality rate are more than twice the national worker fatality rate average (Bureau of Labor Statistics, 2015). These working conditions have pushed Inspector salaries upward to where the average is more than $71,000 a year, according to the BLS (Morris, 2015). BNSF is modifying its digitalization strategy in recognition of the unprecedented data gathering capabilities of drones because this disruptive technology can maintain if not increase the number of track inspections with far less human capital deployment.

Farmers, the second of the five industries identified by the Teal Group to use drones in their operations just like that were empowered with superior precision agriculture. Drone sensors and imaging capabilities gave farmers unexpected ways to increase yields and reduce crop damage (Anderson, 2014). Enhanced crop scouting, plant health monitoring, 3D terrain mapping, irrigation management, and crop damage assessment were all improved and direct technology offshoots (American Farm Bureau, 2015).

Munson Farms, a 4,000-acre corn farm in Missouri, as recently reported on February 19, 2015, set out to test this technology (Miller, 2015). By gathering data from drones—through possible weekly, daily, and even hourly crop surveys—and subsequently developing a management zone map based on near infrared imagery of plant density, Munson Farms was not only able to determine what parts of their fields needed fertilizer and which did not but they could also see where the plants were chest high and where those were only waist high. This identification allowed waste prevention of both fertilizer and water irrigation thereby quantifying the benefits of using the technology to transform precision agriculture.

These examples elucidate that this technology is disrupting industries requiring the inclusion of drones as a major component in developing business and digitalization strategies. Drones are advancing at a use rate double that of any other electronic and industries are finding new and untold uses. Backed by cloud services and big data techniques, the unprecedented data gathering capabilities of drones have the potential to alter the competitive dynamics of the information landscape radically.

The Future of Drones

While the rapid growth of the drone industry has outpaced the development of rules and systems to govern their use, regulatory clarity is on the horizon. NASA is leading the way to unlock this demand by directing a multibillion-dollar effort to develop a US airspace management system capable of safely coordinating manned and unmanned flight. Concurrent with this endeavor the Federal Aviation Administration (FAA) is seeking to ease restrictions that allow commercial drones to reach their full potential.

The industry is beginning to accelerate the evolution and uniting technology with drone big data management apps, and in doing so, drones are emerging as the new platform driving greater data flows all of which will demand accelerated computing power. Filling this processing power demand, Intel announced their commitment to exploring flight. Illustrating this drone technology commitment the Intel family of companies now include: Volocopter the world's first certified drones for manned flight; Yuneec the leader in hobbyist radio controlled electric aviation; Precision Hawk that collects and processes aerial survey data through sensors mounted on unmanned aerial vehicles; and

Airware that provides an operating system for commercial drones, allowing enterprises to take full advantage of aerial data services.

As commercial drone use becomes further unlocked with accommodating regulation, autonomous flight operations will be common daily occurrences everywhere. Increased drone use will skyrocket data collection at unprecedented rates beyond the stratosphere of zettabytes. This technology is an opportunity for greater efficiency and cost reduction of yet unknown proportions. This avalanche of incoming data requiring in-depth analytics will usher in the complete dependence on predictive intelligent machines.

The dawn of independent drone systems will have far-reaching consequences for many industry sectors as well as societies daily lives. The world has now entered an era where replacing human labor by intelligent machines in an ever increasing range of tasks will become one of the biggest challenges for society.

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EB Programs: An Untapped Source of Funding for Small Businesses

By Peng Chiew Chan, MBA, JD

Abstract

Many small businesses are in need of capital, be it to grow or simply to survive. Some have even turned to "hard money" and paid exorbitant interest rates. In this article, I would like to bring attention to a forgotten or never thought of source of financing for the small business - the foreign investor.

Introduction

There are two types of foreign investors - the individual and the company. In both cases, the main objective is to secure a green card or immigrant visa for the investor, while providing a significant potential source of business capital for U.S. entrepreneurs.

I. EB-5 Program

The individual investor program is popularly known as the EB-5. This program was created by Congress in 1990 and enables foreign investors to obtain green cards if they invest in U.S. businesses and create or preserve jobs for U.S. workers. The regulations can be found at 8 CFR 204.6 and 8 CFR 216.6.

10,000 visas are available each fiscal year for the EB-5 investors. 3,000 of these visas are set aside for those who invest at least $500,000 in targeted employment areas (rural or high unemployment) while the remaining 7,000 visas are for investments of at least $1 million in non-tea areas. These amounts are expected to go up to $1.35 and $1.8 million respectively later this year.

This massive inflow of capital can be invested in a new business, existing business or a failing business. The investment has to create 10 full-time jobs within a two-year period. A small business entrepreneur can participate in this program in any number of ways - by helping the foreign investor open and run a new business, using the foreign investor's funds to expand his existing business or selling his failing business to a foreign investor and avoiding bankruptcy.

Currently, at least 90 percent of the EB-5 investment dollars have to go to major real estate development projects that operate as regional centers. There are many projects around the country that are taking advantage of this financial windfall, including the LA Marriott, SLS Casino (Las Vegas), hospitals, ski resorts and dairy farms. In return, the investors get their green cards and about a 1 percent return on their capital upon completion of the project. Yet, the demand for green cards from the Chinese investors is so great that there is at least a three-year wait before they can even apply.

Key Aspects

Some key concepts to know about the EB-5 program are:

1. **Capital**. This can be in the form of cash, equipment, inventory or indebtedness secured by assets owned by the EB-5 investor. The investor must establish that he or she is the legal owner of the capital investedand that the capital was derived through lawful means.

2. **Investment**. The investor has to show that his funds were lawfully derived and that they have been put at risk. Having an empty storefront is not enough. There has to be business activity. The investor's new business may invest in other businesses or projects but he may not spread his initial investment in more than one new business or project.

3. **Targeted Employment Area.**. A targeted employment area (TEA) is a rural area (under 20,000 population) or an area with high unemployment (at least 150 percent of the national average). Each state government is allowed to designate a geographic or political subdivision within its boundaries as a targeted employment area based on high unemployment In California, this is done through the Governor's office.

4. **Comprehensive Business Plan**. The investor has to produce a comprehensive and credible business plan with a description of the business, its products or services (or both), and its objectives. The plan should contain a detailed market analysis and set forth the company's organizational structure, its personnel's qualifications, the company's staffing needs, a timetable for hiring, job descriptions for all positions, and sales, cost, and income projections.

5. **New Commercial Enterprise**. A commercial enterprise is any lawful for-profit activity. These can be sole proprietorships, partnerships (whether limited or general), holding companies, joint ventures, and corporations. Non- commercial activities, including owning and operating a personal residence or non-profit, do not qualify**.**

6**. Expansion of an Existing Business**. The investor can invest in an existing business provided there is a substantial change in the net worth or number of employees. Substantial change means 40 percent increase either in the net worth or in the number of employees.

7. **Engagement in Management of New Commercial Enterprise**. The investor must be actively involved in the management of the new commercial enterprise, either through the exercise of day-to-day managerial responsibility or through policy formulation. As evidence, the investor will have to describe the position he holds in the company and his job duties or show that he is a board member.

8. **Full-Time Positions for Qualifying Employees.** The investment into a new commercial enterprise must create at least 10 full-time jobs for qualifying employees. The investor, his/her spouse, children, or any nonimmigrant are not considered qualifying employees. A full-time job requires a minimum of 35 working hours per week and should last at least 2 years. Temporary or seasonal jobs do not qualify as permanent full-time jobs.

9. **Measuring Job Creation in a Troubled Business.** If the new commercial enterprise is a troubled business, the investor must show that the number of existing employees is being, or will be maintained at least for at least 2 years.

The investor must show that 10 jobs have been preserved, created, or some combination of the two

A troubled business is defined as a business that has; (a) been in existence for at least 2 years; (b) has incurred a net loss over the past 12 to 24 months; and (c) had a loss for the same period at least equal to 20 percent of the troubled business' net worth prior to the loss.

II. EB-1C Program

The second program, known as the EB-1C, is aimed at multinational executives or managers and can be found at 8 CFR 204.5(j). This is for foreign nationals who have their own businesses abroad or who occupy upper level management positions in foreign companies. Here, a foreign company would either set up a subsidiary or purchase a controlling share of a U.S. company. If the U.S. company has been in operation at least a year, an immigrant visa petition can be filed by the U.S. company for one or more of the executives from the foreign parent company.

There are at least two advantages of the EB-1C over the EB-5 program.

First, if the U.S. subsidiary has been in operation at least one year and is profitable, it can request expedited processing of the immigrant visa petition for the executive or manager from the parent company. There is an additional fee that must be paid but the government is obligated to respond within 15 working days.

In the best case scenario, a foreign executive or manager could get a green card within seven months from the petition was filed.

Second, the executive or manager is getting a permanent green card. In contrast, the EB-5 applicant has to wait three years or possibly longer just to get a two-year temporary green card. Before the green card expires, the

EB-5 applicant has to file another application to remove the conditional status and wait another thirty months before he can receive his permanent green card.

Definitions

The following definitions are useful to understand how this program works:

Affiliate means:

(A) One of two subsidiaries both of which are owned and controlled by the same parent or individual;

(B) One of two legal entities owned and controlled by the same group of individuals, each individual owning and controlling approximately the same share or proportion of each entity; or

(C) In the case of a partnership that is organized in the United States to provide accounting services, along with managerial and/or consulting services, and markets its accounting services under an internationally recognized name under an agreement with a worldwide coordinating organization that is owned and controlled by the member accounting firms, a partnership (or similar organization) that is organized outside the United States to provide accounting' services shall be considered to be an affiliate of the United States partnership if it markets its accounting services under the same internationally recognized name under the agreement with the worldwide coordinating organization of which the United States partnership is also a member.

Doing business means the regular, systematic, and continuous provision of goods and/or services by a firm, corporation, or other entity and does not include the mere presence of an agent or office.

Executive capacity means an assignment within an organization in which the employee primarily;

: (A) Directs the management of the organization or a major component or function of the organization;

(B) Establishes the goals and policies of the organization, component, or function;

(C) Exercises wide latitude in discretionary decision-making; and

(D) Receives only general supervision or direction from higher level executives, the board of directors, or stockholders of the organization.

Managerial capacity means an assignment within an organization in which the employee primarily:

(A) Manages the organization, or a department, subdivision, function, or component of the organization;

(B) Supervises and controls the work of other supervisory, professional, or managerial employees, or manages an essential function within the organization, or a department or subdivision of the organization;

(C) If another employee or other employees are directly supervised, has the authority to hire and fire or recommend those as well as other personnel actions (such as promotion and leave authorization), or, if no other employee is directly supervised, functions at a senior level within the organizational hierarchy or with respect to the function managed; and

(D) Exercises direction over the day-to-day operations of the activity or function for which the employee has authority.

Multinational means that the qualifying entity, or its affiliate, or subsidiary, conducts business in two or more countries, one of which is the United States.

Subsidiary means a firm, corporation, or other legal entity of which a parent owns, directly or indirectly, more than half of the entity and controls the entity; or owns, directly or indirectly, half of the entity and controls the entity; or owns, directly or indirectly, 50 percent of a 50-50 joint venture and has equal control and veto power over the entity; or owns, directly or indirectly, less than half of the entity, but in fact controls the entity.

Generally, USCIS considers an applicant to be an executive or manager if the personnel that he directly supervises are professionals.

Conclusion

An entrepreneur who is in need of capital to start, expand or save his or her business should seriously consider financing through the EB-5 or EB-1C programs. There has to be a reason why there are at least 800 active major projects around the country that are soliciting funds from these foreign investors. It would not hurt for the small business to get a tiny slice of this pie.

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