

THE RISE AND FALL OF WEBSMART INTERACTIVE: A CAUTIONARY TALE

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ACADEMIC ABSTRACT

WebSmart Interactive, a seemingly successful entrepreneurial start-up and recipient of public business incentive funds, closed abruptly, leaving unpaid workers, allegations of consumer fraud, discredited public officials, a divided community, and bankruptcy for the firm's principals. WebSmart Interactive's story provides insights about opportunity recognition, the ambiguity of entrepreneurial opportunism, and possibly criminal entrepreneurship. As a cautionary tale, it provides lessons about structuring incentives to aid entrepreneurship both for the good of the entrepreneur and the overall good of society. In addition, the case tells the story of the rise and fall of a start-up business.

EXECUTIVE SUMMARY

WebSmart Interactive was founded at the height of the Internet boom by a team of Minot, North Dakota entrepreneurs. While the firm's name sounded high tech, it began as a provider of telemarketing sales verification. Starting with a handful of employees in March, 2000, the firm grew rapidly with the help of hundreds of thousands of dollars of economic development incentives provided by taxpayers. By April, 2003 WebSmart employed over 620 people in Minot and Grand Forks, North Dakota, and Saskatoon, Canada.

As the industry became more competitive, WebSmart Interactive obtained a different mix of business, especially outgoing sales calls. One of its key outgoing sales clients was a Georgia-based firm targeting consumers normally unable to obtain credit cards. The product was a stored-value card marketed to customers who believed it was a credit card. When the Georgia firm failed to transmit two wire transfers of nearly \$400,000, WebSmart Interactive closed. The April, 2003 closure was so abrupt that employees reporting to work found WebSmart Interactive's doors locked.

Employees were owed unpaid wages and various legal actions began. Municipalities sought recovery of economic incentive funds. North Dakota filed a lawsuit for \$200,000 to recover unpaid wages, as well as a lawsuit for defrauding 250 North Dakotans with bogus credit cards. Eventually the firm's principals filed for bankruptcy.

To answer the "So what?" question the case provides: 1) a description of opportunity recognition, opportunism, and possibly criminal entrepreneurship in practice; 2) a description of economic incentives and flaws in their construction; 3) a fine-grained history of a start-up's failure. Point one is useful to build theory that better defines and distinguishes entrepreneurial opportunity seeking, opportunism, and criminal entrepreneurship. Point two is useful to critique and construct better-conceived incentive systems. Point three adds to the general body of entrepreneurship knowledge.

INTRODUCTION

The cool April morning began like any other workday for Randi Galegher, a telemarketer for WebSmart Interactive. However, arriving at work, she and other employees found the front door locked and a sign stating, "Effective April 24th, 2003 WebSmart Interactive is closed until further notice. Please call 1-800-XXX-XXXX for details or visit www.websmartinteractive.com" (Crites, 2003: A1).

There was no advanced notice of the closure or that the company was in trouble--just a note on a locked door. WebSmart Interactive's employees were puzzled and angered by the abrupt closure, and Randi, like many others, faced a bleak future.

Most of WebSmart Interactive's workers received modest wages (around \$7.50 per hour) and for the working poor not getting the money you are owed is devastating. On the day WebSmart Interactive closed, Randi had "\$5 in her wallet, a 3-year old daughter to feed, with rent and day care bills to pay" (Springer, 2003c: A1). All told, the closure left more than 620 people out of work wondering if they would ever get paid (Rafferty, 2003c; Springer, 2003a).

COMPANY BACKGROUND: THE SALAD DAYS

WebSmart Interactive was founded at the height of the Internet boom by two prominent Minot, North Dakota attorneys, John Skowronek and Robert Lamont. While the firm's name sounded high tech, it began as a provider of third party sales verification for telemarketing firms. One business mainstay was providing verification services for long-distance telephone companies. Another early client was MLT, a travel/tour company and subsidiary of Northwest Airlines (Rafferty, 2000).

Starting with a handful of employees in March 2000, the firm grew rapidly. By June of 2000 the firm had 40 employees working in Minot.

The future looked bright for WebSmart Interactive. As the old saying goes, it was in the right place at the right time. Teleservices were growing, and depressed rural areas offered generous job creation incentives. Moreover, most of the incentive formulas were primarily tied to the number of positions created and secondarily concerned with job quality (wages, benefits, and hours) and overall economic benefit (economic multiplier, and skill and knowledge building potential). For economic development agencies and their sponsoring city and state governments, tension existed between requiring restrictions governing the use of incentive funds, stipulations on the amount of owner's equity required, strict performance benchmarks, detailed and timely compliance monitoring, and give-backs if the enterprise didn't meet its development goals. One school of thought advocated imposing as few restrictions and requirements as possible since rural areas have disadvantages (e.g., remoteness, lack of infrastructure, lack of skilled/educated labor, unsophisticated business and residential environment, etc.) and there was an economic development arms race going on pitting one community's incentive package against those of other communities.

Thus, as WebSmart Interactive acquired new clients and continued to grow, it looked for more employees and financing (Minot Area Development Corporation, 2000).

In Minot, ND the first stop for businesses seeking funds is the Magic Fund and the Minot Area Development Corporation (MADC). The Magic Fund is a development fund whose monies are collected from sales tax receipts. The MADC is a corporation associated with the City of Minot that provides a variety of business promotion services including finding local, state, federal, and private funds and combining these into comprehensive incentive packages. In mid-2000 WebSmart Interactive filed a Magic Fund Application (2000) requesting a forgivable \$230,000 grant from the Magic Fund, the conditional donation of a tract of land in northwest Minot provided by the City of Minot worth \$60,000, a \$300,000 loan from the North Dakota Development Fund, a \$280,000 grant from a Community Development Block Grant, and a \$282,000 loan/grant from Workforce 2000, a job training program. According to WebSmart Interactive's Magic Fund Application (2000), First Western Bank and Trust of Minot would provide a construction loan of \$332,000 and the owners would invest \$100,000 cash to be used for technology. All together, the application package submitted under John Skowronek's signature (grants, loans, land, and owner's equity) totaled \$1,584,000.

Several weeks later, the formal agreement detailing incentive sources and amounts and WebSmart Interactive's obligations had morphed; no longer was there a requirement for the owners to invest \$100,000 equity (Development Agreement, 2000). "The funding for the Project is contemplated to consist in part of an initially interest free and conditionally forgivable loan from Minot in the amount of \$230,000; a conditional donation of land from Minot valued at approximately \$60,000; a Bank of North Dakota issued or insured loan under the "Pace" program; and North Dakota Job Service Training funds in an amount of not less than \$238,000" (Development Agreement, 2000). In return, WebSmart Interactive was obligated to build a new building with at least 13,000 square feet ready for occupancy no later than December 1, 2000 and to invest not less that \$1,350,000 in the building and in equipping the building. It was obligated to "use commercially reasonable efforts in good faith to employ at a wage range of not less than \$7.50-\$10.00 per hour plus benefits: 40 employees on or before August 7, 2000; 30 more employees on or before August 7, 2001; 30 more employees on or before August 7, 2002; 25 more employees on or before August 7, 2003; and 25 employees on or before August 7, 2004" (Development Agreement, 2000: 1).

While the incentives provided by Minot totaled \$290,000, no collateral was required (Springer, 2003c). However, to remain in compliance, by August 7, 2003, WebSmart Interactive would need to employ 125 employees and by August 7, 2004, 150. However, per the agreement, full time employees were defined as working 32 hours per week for 26 of the immediately proceeding 39 weeks. "In the event WebSmart is unable to employ 150 people by August 7, 2004 the \$230,000 grant will be repaid upon the number of employees actually employed" (Development Agreement, 2000: 3).

According to Minot attorney and Magic Fund critic, Bob Hale (2003) "John Skowronek (an attorney) re-wrote the deed which transferred taxpayer-owned land to WebSmart, allowing him to use the land as collateral" and the city attorney simply agreed. In a Fargo Forum article Patrick Springer (2003c: A12) wrote, "In fact \$1.3 million was borrowed in a series of loans from First

International Bank and Trust in Minot, largely owned by the Hoeven family. One of the loans was split in half with the state owned Bank of North Dakota which loaned \$500,000-and a subsidy of more than \$60,000 to "buy down" the interest rate."

WebSmart Interactive garnered yet more funds. In mid-December, 2000 a regional development entity, the Souris Basin Revolving Loan Fund provided a \$63,000 loan to WebSmart Interactive (Northwest Central District Court North Dakota, 2003a).

By early 2001, WebSmart Interactive occupied its new building. According to the Minot Area Development Corporation, the new building was equipped with the most technologically advanced equipment and software that allowed the company to expand its service offering. The new services included e-mail response, live agent web assistance, and voice over protocol services. With these capabilities the building was capable of supporting 230 employees (Minot Area Development Corporation, 2000).

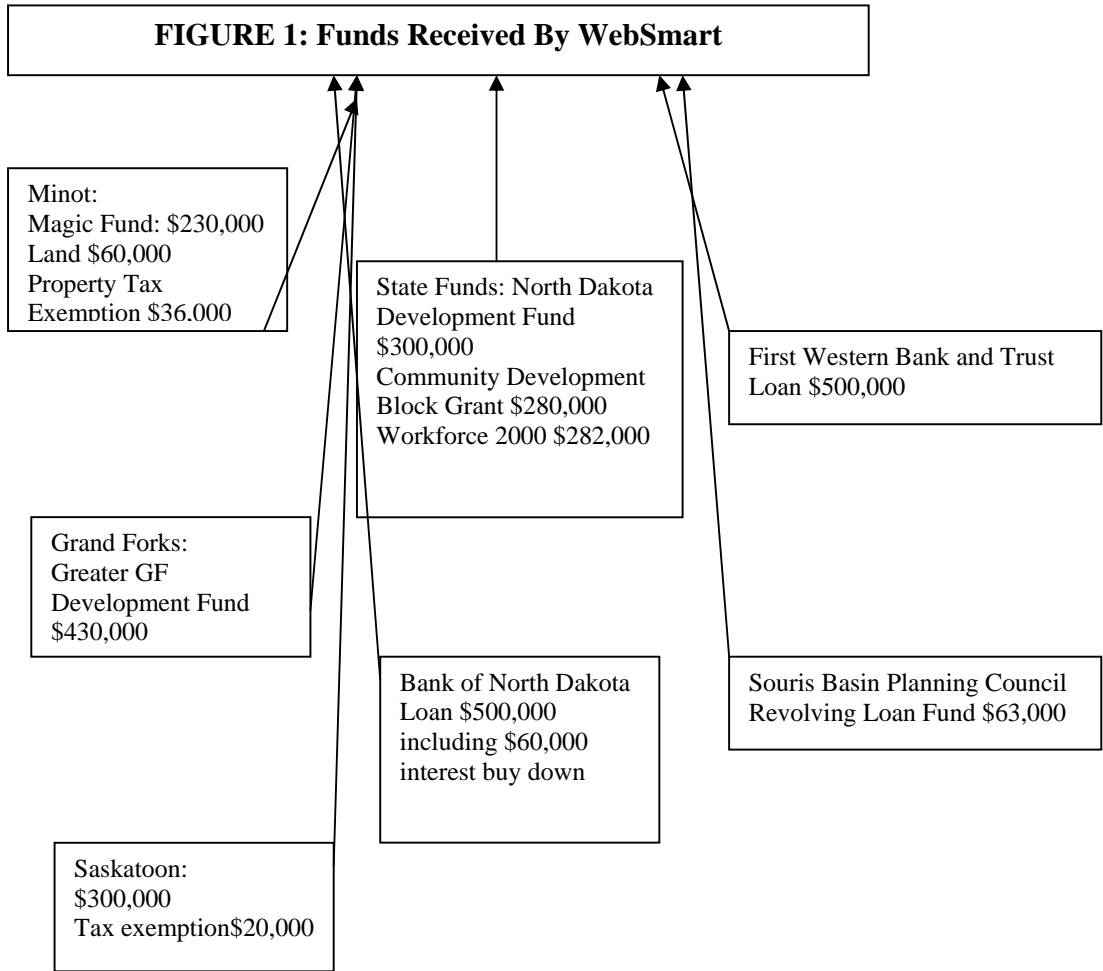
WebSmart Interactive was toasted as a local economic development success. Moreover, the successes of Minot's economic development efforts were used in John Hoeven's successful 2000 Gubernatorial Campaign.

Others came to hold less sanguine views. Cheryl Brown, a newly minted college graduate, was hired by WebSmart Interactive as a trainer. First thrilled with a professional job that offered excitement and purpose, Brown soon became disillusioned with the atmosphere of WebSmart Interactive and its management, and despite the difficulty of finding comparable employment, quit. Brown noted that immediately after the Magic Fund payment came in all the owners had new Chevy Suburbans (Brown, 2002).

Later in 2001, WebSmart Interactive acquired two call centers from Z-Tel in Grand Forks, ND and Saskatoon, SK. In addition, the Z-Tel acquisition brought three management level people and seven IT people to WebSmart Interactive (Sovak, 2001). The acquisition was facilitated by loans from the Greater Grand Forks Growth Fund of over \$400,000, and Saskatoon paid WebSmart Interactive \$300,000 to train employees and gave \$20,000 worth of tax exemptions (Rafferty, 2003d).

In October 2002, WebSmart Interactive was granted a property tax exemption for three years by the City of Minot worth \$36,000 (Rafferty, 2002). Incredibly this exemption came while two loans worth over \$400,000 from the City of Grand Forks, were in default (Rafferty, 2003a).

During this time the company also gained an additional owner, Marius "Buzz" Stitzer. Later, a fourth owner, Patrick Connor, joined WebSmart Interactive.



COMPANY BACKGROUND: WEBSMART INTERACTIVE' OWNERS

Three of WebSmart Interactive's owners, Robert (Bob) Lamont, John Skowronek, and Marius (Buzz) Stitzer were prominent and well-known figures in the Minot community. The fourth owner, Patrick Conner, was not, had few apparent connections to the community, and his role in WebSmart Interactive was not publicly defined.

Mr. Lamont and Mr. Skowronek were law partners and each was prominent in the community. Mr. Lamont was WebSmart Interactive's Secretary Treasurer and knew people and processes. He had been a member of the Board of Directors of the Minot Area Development Corporation (MADC) for many years, going back to when John Hoeven was its Chairman, Curt Zimbelman an officer of First Western Bank and Trust, was a fellow board member, and Lee Peterson was just beginning as the President of MADC (Minot Area Development Corporation, 1991). Mr. Lamont even helped draft a key economic incentive agreement between the City of Minot and a business, MLT, in 1999 (Development Agreement Draft, 1999). Lamont was a contributor to Hoeven's gubernatorial campaign and was later appointed by Gov. John Hoeven to the North Dakota Development Foundation (Springer, 2003d).

John Skowronek served as WebSmart Interactive's President and CEO. Mr. Skowronek knew people and processes and served as the public face of WebSmart Interactive. He was a member of the Economic Development Alliance and of the Vision Foundation--both of which had substantial involvement with economic development in Minot. Mr. Skowronek was named the Chair for Economic Development for the Vision Foundation (Minot Chamber of Commerce, 1999). Mr. Skowronek also served as Chair of Minot's Parking Board (Sovak, 2003a) and was a contributor to Hoeven's gubernatorial campaign (Springer, 2003d).

Buzz Stitzer served as WebSmart Interactive's Senior Manager and was similarly knowledgeable and connected, but in addition, Stitzer knew the ins and outs of telemarketing. Mr. Stitzer had been involved in a number of telemarketing businesses with Minot connections including ProMark One, DirectTel, Z-Tel and now WebSmart Interactive; all told, he had almost a decade's experience in the industry (Springer, 2003d). His record of public service was similarly distinguished; Stitzer was MADC's Treasurer in 2000 (Minot Area Development Corporation, 2000) and later became the MADC's Chairman in 2002 (Springer, 2003d).

TELESERVICES INDUSTRY AT A GLANCE

WebSmart Interactive participated in the teleservices industry. At the time WebSmart Interactive began, the teleservices industry could be categorized by three service activities: out-bound calling, in-bound calling, and third-party verification services.

Initially WebSmart Interactive provided third-party verification services for other companies. Later, when third-party verification dried-up, WebSmart Interactive actively pursued out-bound calling contracts.

Third-party verification: When a company sells something over the phone it is required by various government agencies to have an independent party verify that the customer has ordered

the product or has requested a change in service. The third party verifier will ask the customer to verify his/her identity, confirm that he/she is an authorized decision-maker, and verify the transaction. These steps makes telephone transactions legally binding as long as the verification was recorded and is available for audit for a minimum of 24 months (Wikipedia, 2007a).

Who uses the service of third-party verification? Anyone who is involved in the long distance industry, telemarketing industry, or anyone who would have problems getting a signed contract as a result of distance constraints. This allows companies to prove that a consumer agreed to the sale or other transaction using email or the telephone and to obtain a legally binding contract in the process. Third party verification is now used by a variety of organizations including the government (Wikipedia, 2007a).

Out-bound calling: Out-bound calling is initiated by the marketing firm. Existing or potential customers are contacted directly and the customer may be asked to purchase an item, subscribe or change services, or make a donation to a charity (Wikipedia, 2007b).

In-bound calling: In-bound calls are initiated by the individual and involve the reception of incoming orders or information requests. Demand is created by outside publicity or advertising (Wikipedia, 2007b). In general, in-bound calling has a better public perception than out-bound calling since the individual initiated the product or information request.

TELESERVICES INDUSTRY: A RECENT HISTORY

Business process outsourcing has become very popular in recent decades. Companies providing accounting, human resources, and call centers have benefited as other firms have sought to save money while shedding non-core functions.

In general, teleservices (placing out-bound calls, taking in-bound calls, and providing third-party verification) is low paid work with phone technicians starting at \$6.50 per hour and involves dealing with callers who can be irate and rude (Morse, 2004). Moreover, the industry is not known for employment stability due to cost competition (Morse, 2004) and the fact that outsourced teleservices contracts tend to have short durations.

A number of forces are shaping the modern teleservices industry. First, providers of teleservices must do so in a cost effective manner. Led by call center operators such as Sykes Enterprises, operations first moved to low-cost US locations such as Appalachia and the Great Plains. Moreover, local economic development agencies in these depressed regions offered hefty incentives to call centers promising job creation. For example, the Bismarck-Mandan (North Dakota) Development Association put together a \$4.5 million package to land two large Sykes call centers (Morse, 2004). Similar packages were given to Sykes to develop large centers in the Iron Range of Minnesota (Eveleth, MN--\$4.01 million), eastern Kentucky (Pike and Perry Counties--\$7.6 million), and western Nebraska (Scottsbluff, NE--\$1.5 million) (Morse, 2004).

With the US stock market decline beginning in early 2000 and the economic slowdown after September 11, 2001, clients demanded still lower teleservices costs. Taking advantage of modern communications infrastructure, some operations closed US centers and moved offshore. For

example, after taking incentives from economic development agencies to start call centers, Sykes closed centers in North Dakota, Minnesota, Kentucky, and Nebraska, shifting the work overseas (Morse, 2004). Popular low-cost locations include India, the Philippines, China, and Central America.

Certainly not all US call centers were offshored, but firms operating in the industry have had difficult times. A good example of this is a call center in Ashland, Wisconsin. The center opened in 2000 only to close after 9/11 as business fell dramatically. The center was later reopened in 2002 and the employment level had doubled by mid 2004 (Jossi, 2004).

While not yet in effect at the time of WebSmart Interactive's closure, the Do Not Call Implementation Act of 2003 signed into law by President Bush on March 11, 2003 (Wikipedia, 2007c) had a chilling effect on the teleservices industry. The act created the Federal Communication Commission's National Do Not Call Registry as a means to allow consumers to regulate and limit the number of telemarketing calls they receive. With registration, telemarketing companies must remove the consumer's telephone numbers from their call lists and registering allows consumers to file complaints if called (Wikipedia, 2007c).

In a survey by the American Teleservices Association, the National Do Not Call Registry has reduced the number of telemarketing calls by 50 percent daily, which means a reduction in the number of employees making calls (Jossi, 2004).

Another industry change is the move away from large domestic call centers to smaller centers employing as few as ten workers. Today companies introducing new products or services need quick and flexible help (Morse, 2004).

COMPANY BACKGROUND: IT'S A DOG EAT DOG BUSINESS

By early 2003 the industry had changed dramatically. According to Bob Lamont, third-party verification for long-distance telephone companies ended when the long-distance companies quit using call centers to sell long distance services (Rafferty, 2003b). More companies were fighting for fewer contracts; "that competition has driven rates down making it more difficult to turn a profit without changing your business strategy" (Stitzer & Skowronek, 2003: 4). As a result of increasing competition and decreasing demand, WebSmart Interactive sought other types of telemarketing contracts. One such contract came from Global Financial Inc.

Global Financial was supposed to provide to customers who had poor credit prepaid Visa or MasterCard Membership packages that offered a credit card that was interest and deposit free. Each package cost around \$220.

After these customers had provided bank account information the money was debited from the customer's accounts but the customers rarely saw the membership packages. According to the Georgia Consumer Affairs Office, Global Financial provided the information to a company called Global Fulfillment, which randomly shipped membership benefit packages. They included promises of \$500 in grocery coupons, \$100 in gas rebates, free satellite dishes and long distance service, among other things. The packages were to include a login name and password to access

the benefits; however, the passwords were invalid and access was not possible. Global Financial was WebSmart's biggest client (Smith, & Sugiura, 2006).

The problems with Global Financial were not unknown to WebSmart Interactive's employees or owners and the relationships with Global Financial were close. "WebSmart Interactive had been telemarketing on behalf of Global from the fall of 2002" (Haight, 2003:). WebSmart Interactive employees knew that customers weren't receiving the pre-paid cards since at least February, 2003 questioned their supervisors if Global Financial was legitimate (Rafferty, 2003c). WebSmart Interactive supervisors told them to give a 1-800 number (that was always busy) to angry Global Financial customers and never mention WebSmart Interactive when dealing with the customers (Rafferty, 2003c). In addition, WebSmart Interactive employees both sold Global Financial's cards and provided third-party verification services for these sales--for instance, at its Minot center about 25 WebSmart Interactive people verified the Global Financial sales of fellow WebSmart Interactive employees (Rafferty, 2003c).

The troubles with Global Financial became well known to the public. By early spring 2003 a consumer protection website, www.ripoffreport.com, hosted numerous complaints about Global Financial and since one of the sellers of the Global Financial product was WebSmart Interactive's Saskatoon subsidiary, the Saskatoon Star Phoenix ran a story about the complaints.

In its April 15, 2003 WebSmart Interactive Inc. Newsletter, Buzz Stitzer and John Skowronek wrote the following commentary about Global Financial Inc. and a new company, Vertex One.

We began working for a small company called Global Financial about 9 months ago. They were and still are, on the cutting edge of a product that we will be seeing more and more of. It has become obvious to us that Global was in the right industry at the right time but unfortunately, perhaps because of the age of their company, they were not adequately prepared for the success we helped them achieve. We have been working with the Global group since early January when it first became apparent that they were unable to adequately handle the fulfillment and customer service issues of their rapidly growing customer base. When a company like Global drops the ball on its customer service, people panic. Many of you may or may not have heard of the story that ran in the Saskatoon Star Phoenix a couple weeks ago, where some bored investigative reporter went on some Internet site and read of some customers of Global that were calling the Global product a sham because they had not yet received their membership packets. Calling the product "illegal". They were screaming fraud and rip-off; rightfully so. If a company sells a product, and then fails to deliver the product in a timely manner, the customer has a right to be upset. And because we were the sales agent, we have the right to be upset. And we were. And we addressed our concerns with Global in no uncertain terms. But the product isn't illegal, and it isn't a fraud. It was just executed poorly from the fulfillment and customer service.

We had given Global a timeline to get their house in order, and while they have made progress, the progress in not adequate in our minds. We have worked diligently with various partners that were in the Global consortium, and have partnered with them to help them form a new company, that will offer a similar product, that will be structured in

such a manner that will address the issues that the former group could, collectively, not adequately address with Global.

So, by the time you read this we will have significantly, if not completely migrated our Global sales to another company offering a similar product as Global. We worked with our partners to help them form a new company that had a product that is similar because we have proven that we know how to sell that product. The company we helped them form is called Vertex One" (Stitzer & Skowronek, 2003: 1 & 4).

According to employees, the sales script for Vertex One was identical to that of Global Financial (Rafferty, 2003b). "For the last three weeks it was in business, WebSmart telemarketed for Vertex One Benefits Group. Its membership package was almost identical to Global's although the price was slightly lower at \$219.94" (Haight, 2003:). The cost of the Global Financial package was \$221.95 (Haight, 2003).

However, telemarketing work was cut short for WebSmart Interactive soon after authorities executed a search warrant on April 17, 2003 of the Georgia offices of Global Financial Inc. seizing computers and freezing bank accounts. According to WebSmart Interactive's owners, wire transfers of nearly \$400,000 were due from Global Financial between April 21st and 28th. Since the funds were not received, WebSmart Interactive abruptly and permanently closed its doors on April 23, 2003 (Rafferty, 2003a; Rafferty 2003b). The closure left about 620 people out of work and according to Skowronek, without pay for two weeks work amounting to about \$338,000 (Rafferty, 2003d). Some employees claimed that they were owed for a month's pay since their last pay checks were returned marked NSF, (i.e., nonsufficient funds), and that their health insurance, long-term disability, and short-term disability payments had been withheld but not paid to Blue Cross Blue Shield (Lawson et al., 2003; Williams, 2003).

According to John Smith of the Georgia Governor's Office in Consumer Affairs, investigators "are convinced Global is just a new name for another telemarketing company, Lennox Capital Inc." "It seems like they open one and as soon as that one gets in trouble they open another one and start closing down one. We have reason to believe they probably have more than one operation" Haight, 2003:). Smith estimated that Global Financial produced about \$1,000,000 a month in sales (Rafferty, 2003b).

After WebSmart Interactive closed and when asked about Vertex, Skowronek said he was having trouble contacting Vertex, only learned of Vertex through a broker, and was "waiting for the broker to return his phone call" (Haight, 2003:). Skowronek continued, "I don't talk to them (Vertex). Most of our conversations with them was through these brokers." "I don't know how these companies get formed. The brokers set them up and get the people involved. It was different folks than Global" (Haight, 2003).

AND THEN THE SCREEN WENT BLANK

In a press release written in the third person and dated May 2, 2003, a week and a half after the closure, WebSmart Interactive's President and CEO John Skowronek lashed out at investigators, journalists, and others saying, "Anyone that would look at one of our centers, picks up the local

newspaper, and when they do that and sees the way WebSmart has been treated through this, their first inclination is to head to the hills." The news release continued with "Skowronek said that the Minot Daily News Publisher Jim Eykyn told Skowronek Wednesday afternoon that he (Eykyn) and Minot Daily News Publisher Brian Obenchain, met and decided to stop the negative news campaign until there was positive news to report" (WebSmart Interactive, 2003)

True to its word, the Minot Daily News ended investigative coverage of WebSmart Interactive since there was no more good news to report. This left the Fargo (ND) Forum located 260 miles away in Fargo, North Dakota's largest town, to continue investigative coverage of WebSmart Interactive and the questions it raised about economic development (Springer, 2003a; 2003b; 2003c; 2003d; 2003e; 2003f; 2004a; 2004b; 2004c).

SMALL TOWN FOLKS

North Dakota is said to be a small town with a really long main street. With fewer than 650,000 people this is almost true. While not all North Dakotans know each other, with such a small population the power elite do know one another.

John Hoeven, a Dartmouth graduate, has served as Executive Vice President of First Bank and Trust of Minot, his family's bank. Later Hoeven was the President of the Bank of North Dakota, the only state-owned bank in the US. Among other purposes the Bank of North Dakota serves as a driver of economic development and source of funds. After resigning from the Bank of North Dakota, Mr. Hoeven successfully ran for and became Governor of North Dakota. Hoeven was listed as a reference on WebSmart's Magic Fund application (Magic Fund Application, 2000). After WebSmart Interactive's collapse, First Western Bank and Trust was listed as the owner of WebSmart Interactive's headquarters real estate (Springer, 2003d). During his time as Chairman of the Board of the MADC, Mr. Hoeven stated that economic development is not about the number of programs available but about the results achieved (Minot Area Development Corporation, 1991).

Curt Zimbelman is employed by First Western Bank and Trust as Vice President of Operations. He has served on the Board of Directors of the MADC. Mr. Zimbelman believes that the MADC is Minot's catalyst for economic development and stated that it was exciting to be a small part of the success at MADC (MADC Annual Report, 1991). Mr. Zimbleman voted as a Minot City Council member to approve the financing for WebSmart Interactive even though he was a senior officer at First Western Bank and Trust. According to Heidi Heitkamp, North Dakota's former Attorney General that was a violation of state law barring conflicts of interest involving municipal officials (Springer, 2003d). Mr. Zimbleman was elected Mayor of Minot in 2002.

Lee Peterson served as President of the MADC when WebSmart Interactive's incentive package was composed (Springer, 2003d). Before serving as the MADC President, Mr. Peterson served as a county commissioner in Idaho, "attended several universities that offer course study in economic development," and served with a Chadron, NE economic development corporation (Minot Area Development Corporation, 1991: 1). In 2001 Governor John Hoeven appointed Mr. Peterson as Commission of Commerce over the newly unified North Dakota Department of Commerce to oversee four entities--the Division of Community Service, the Office of Economic

Development and Finance, Tourism, and Workforce Development (North Dakota Governor's Press Release, 2001). Recently Mr. Peterson left North Dakota state government.

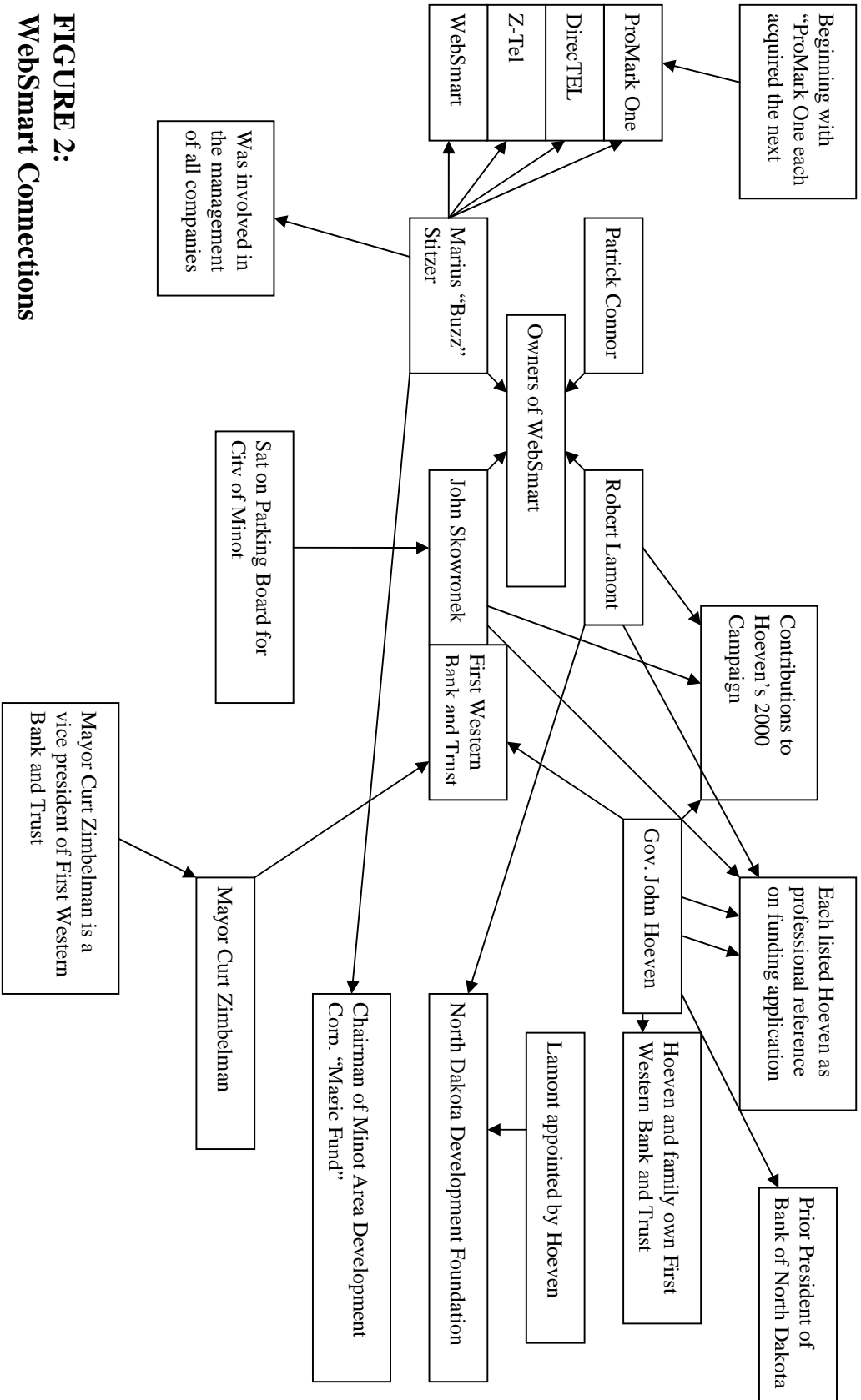


FIGURE 2:
WebSmart Connections

IS IT WORKING?

Minot (Ward County) North Dakota is located in northwestern North Dakota. Its longitude is approximately the same as the Manitoba and Saskatchewan provincial border and it is about 60 miles from the US/Canadian border. The primary revenue sources for the region include agriculture, an air force base, a small university, and various service businesses.

In a 2003 (Springer, 2003e: A8) interview, Economics Professor Steve Huenneke said that, "The Magic Fund has failed to create jobs that boost the city's [Minot's] average wage level. The average wage for a job created by the fund in 1999 reportedly was \$18,642 or 85 percent of average wage for Ward County, \$21,751. The US average wage then was \$33,313. Thus, the average Magic Fund job wage was 56 percent of the US average."

The 2000 US Census reports that Minot and Ward County's populations were 36,567 and 58,795 respectively. According to Census Bureau projections, since 2000, Ward County has lost six percent of its population mostly due to out-migration of its younger people (US Census, 2007).

AFTER THE FALL

Employees

WebSmart Interactive put more than 620 people out of work. Its North Dakota employees were owed over \$200,000 in wages when the company collapsed--the highest wage claim in state history (Spring 2003c). WebSmart Interactive was unable to pay its employees (Rafferty, 2003g; 2003h). As a result, former employees were evicted from their apartments, had to file bankruptcy, and lost their health insurance (Rafferty, 2003c). The State of North Dakota received a judgment for employee wages in the amount of \$206,004.90 plus interest of \$19,912.72. This judgment was entered in October of 2004 (Northeast Central District Court North Dakota, 2004). According to a Grand Forks Associated Press article, while North Dakota's Labor Department has a judgement against WebSmart Interactive of over \$200,000 for unpaid wages, there are "no assets on which to collect" (Grand Forks AP, 2007: B1).

Minot

The City Council decided to turn up the heat by bringing suit against the company for the debt that is owed to the city of Minot. The council also asked that the North Dakota Labor Commissioner, Insurance Commissioner, and the Ward County State's Attorney investigate WebSmart (Rafferty, 2003h). However, to give WebSmart the benefit of the doubt, the city gave WebSmart until after the terms of the Magic Fund contract had expired. The city wanted to ensure that WebSmart didn't comply with the terms of the agreement before it filed suit. The city was not sure that costs of the suit would not quickly outweigh the benefits (Rafferty, 2003k). WebSmart Interactive was unable to satisfy the city for its \$230,000 loan/grant.

Minot got a new call center, Phase 2 Solutions of Scottsdale, Arizona. A reseller of wireless telecommunications products and services, Phase 2 Solutions moved into the location formerly occupied by WebSmart Interactive. Phase 2 Solutions provides customized call center solutions

in areas such as new customer acquisitions, technical support, customer service, and integrated administrative support for broadband products. According to Larry Willett, President of Phase 2 Solutions, “My partner had roots in Minot; Rob Miller, a partner in Phase 2, was an original founder of ProMark One. Therefore his roots and the efforts of the Department of Commerce, MADC, and First Western Bank allowed us to place Minot in the expansion mix” (Sovak, 2003b: A1).

Creditors

SRT Communication Inc. sued WebSmart Interactive for unpaid bills plus interest. SRT was the telephone provider for WebSmart Interactive and SRT was left with \$142,000 worth of unpaid bills. SRT sought 18 percent interest on those bills and asked that the interest be accrued from July 9, 2003 (Rafferty, 2003j; 2003k).

The Souris Basin Planning Council received a judgment against WebSmart on the 25th of November, 2003 in the amount of \$48,223.35. This judgment was in District Court (Northwest Central District Court North Dakota, 2003b).

The Greater Grand Forks Development Fund filed suit for \$420,232.30. This is the amount owed on the loans to WebSmart and includes interest and late fees. The suit is filed in District Court in Sept. 2003 (Northeast Central District Court North Dakota, 2003). The City of Grant Forks, owed loans that would now total \$447,000, ultimately recovered about \$700 from sale of the company's office equipment. In April, 2007 the Chair of the Growth Fund Committee said the city has no way to recover the balance and recommends writing off the loan. This would be the largest write-off in the Growth Fund's history (Grand Forks Associated Press, 2007).

In Canada legal actions were pursued as well. The Saskatchewan Department of Labor has received a court order for WebSmart Interactive to pay \$390,500 (Springer, 2003d).

Consumer Fraud

The State of North Dakota sued WebSmart for \$64,000 for consumer fraud. Two hundred-and-fifty North Dakotans may have been victims of WebSmart Interactive's deceptive selling practices (Springer 2004b). State investigators concluded that WebSmart and its employees deceived consumers into thinking that they were buying credit cards (Springer, 2003a; 2004b; Bismarck Associated Press, 2003).

North Dakota

There has been an increased call for reform in economic development policies. After WebSmart collapsed it was disclosed that the state did not impose any job standards in exchange for \$800,000 in loans made to the business in 2000. By law the only information that can be released regarding low interest PACE loans is the name of the borrower and the amount of the loan (Springer 2003g). If the loan ends up in default it ultimately ends up on the Bank of North Dakota's bad loan list (Springer 2003e).

Accountability is a buzzword that was flying around Bismarck, North Dakota's capital. Many legislators were calling for some sort of accountability. Some legislators were advocating something called a "clawback provision." This provision states that if the business owner doesn't live up to requirements set forth in a loan agreement they are forced to pay the funds back (Springer 2003e: A8). Another issue that is being considered by legislators is making employees the first creditor in line for repayment. They are the ones who worked to make a profit for the company (Springer 2003e).

In 1995, Minnesota passed an economic accountability law requiring disclosure of costs and benefits. It also has job quality standards and public hearing requirements before and after a deal is made. This provides the public information on what subsidies are given and what is expected in return. This law has been credited with bringing higher-pay jobs to Minnesota. It has also been credited with the implementation of pay-as-you-go financing in Minnesota (Springer, 2003e).

Owners

John Skowronek filed for bankruptcy. In Mr. Skowronek's bankruptcy filing he claimed assets of \$387,993.85 and debts of \$3,417,432.95. However, a part of the expenses that he claimed were living expenses in Nevada (US Bankruptcy Court North Dakota, 2004b).

Mr. Skowronek is listed as owner/ operator for Command Center, and is a member of the Reno-Sparks Chamber of Commerce. Command Center provides labor services including employee placement and temporary labor for businesses. The company has been a member of the Reno-Sparks Chamber since 2004 (Reno-Sparks Directory, 2007).

Robert Lamont filed for bankruptcy on the 18th of February, 2004. Mr. Lamont claimed assets of \$371,439 and debts of \$3,067,733. This included a beach home in Panama City, Florida (US Bankruptcy Court North Dakota, 2004a).

Since Mr. Lamont's bankruptcy he is employed with Apple Core Enterprises Inc. Apple Core owns and operates several franchise restaurants in four states--North Dakota, California, Minnesota, and Arizona. Mr. Lamont is listed as the company's CFO (Chief Financial Officer). He is responsible for the financial operations of the business and is also in charge of real estate (restaurantchains.net, 2007).

Marius "Buzz" Stitzer filed for bankruptcy on the 25th of February, 2004. He claimed assets of \$664,000 and liabilities of \$794, 585 (US Bankruptcy Court North Dakota, 2004c). Mr. Stitzer tried to claim a home in Texas under the homestead exemption. Since Mr. Stitzer did not live in Texas and was filing bankruptcy in North Dakota, this was not allowed. As of the February of 2007 his bankruptcy case was not finalized.

After WebSmart Interactive closed Mr. Stitzer began work with Phase 2 Solutions in August of 2003. Mr. Stitzer launched two call centers for Phase 2 Solutions, one in Minot, ND, the other in Rio Rancho, NM. Mr. Stitzer is currently the Head of US operations for etelecare Global Solutions. He is responsible for ensuring that the executive strategies optimize results and maximize profits (etelecare.com, 2007).

Patrick Conner, the fourth owner of WebSmart Interactive, filed bankruptcy on the 15th of October, 2005. He filed in the state of Minnesota where he resides. Mr. Conner claimed assets of \$323,400 and liabilities of \$773,335.67. In the bankruptcy filing he listed his current job as Director of Zero Variance (US Bankruptcy Court Minnesota, 2005). Just two short months after the closure of WebSmart Interactive, Mr. Conner was the CEO of Conner Enterprises Inc. doing business as Zero Variance. This is a Virginia corporation with Operational Headquarters in Minnesota. There was a two year period when the company was not incorporated, according to the annual reports that are required as a part of the incorporation regulations. Zero Variance is a provider of quality, compliance, and performance assurance services. Mr. Conner has been the President and CEO of the company since it was incorporated (zero variance.com, 2007).

CASE LEARNING OBJECTIVES

The case has several learning objectives. This is a case about a failed enterprise alleged to have misused incentive funds and to have committed fraud. Thus, learning objectives concerning entrepreneurial start up, failure avoidance, use and misuse of public incentive funds, and ethical operations will be featured. The learning outcomes are important because this story can be used as lessons in ethical enterprise, avoiding business failure, structuring incentives, and since the entrepreneur and his enterprise are so closely identified, personal failure.

The case is useful for a number of different courses. It could be used in Entrepreneurship, Strategic Management, Business Ethics, and Economic Development courses. In many ways, this company was a small Enron. Stories of quick success, wrong-doing, collapse, and recrimination are sure to keep students' interest. However colorful the subject, the case is intended to teach positive lessons.

CASE THEORETICAL LINKAGES

The case examines entrepreneurial startups, opportunity recognition, entrepreneurial teams, and perhaps criminal entrepreneurship.

The case links entrepreneurship to organizational behavior (e.g., teams, escalation of commitment); to strategic management (e.g., decision making); to criminology (e.g., criminal behavior, criminal entrepreneurship); and to economic development (e.g., incentive structure).

CASE NOTE: DISCUSSION QUESTIONS AND ANSWERS

Question 1

Why did the founders expand so quickly? Wouldn't it have been more prudent to concentrate on WebSmart Interactive's Minot operation before seeking to acquire more businesses?

Answer 1

The founders did what they wanted to do. Minot's incentive funds were not particularly well controlled. In addition, the other communities offered incentive funds for WebSmart Interactive's

expansion. The business was growing so rapidly that a downturn seemed remote. The founders were not very mature. They did not have reasonable expectations about the future of telemarketing.

Question 2

What do you think led the founders to represent a fraudulent product?

Answer 2

The founders had played loose before with the rules and this was perhaps no exception. The company needed the business and so it wasn't picky about its clients or the sales pitch. The founders hadn't start out to commit fraud; they just moved along with the business and it led to fraud. The founders may not have understood the implications of what they were doing.

CASE APPROACHES AND SUGGESTIONS

The case is self-contained. No materials not provided in the case are needed for the case's analysis.

The case can be taught early in the term to build interest in the subject, near the end of the term as a capstone, or to accompany a particular topic, such as ethics. The case should be useful to hone judgment skills, build empathy for stakeholders, and increase sensitivity for ethical behavior and decision making.

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