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Competence or flexibility? Survival and growth implications of competitive strategy preferences among small US businesses

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Abstract

Purpose – Research in strategic management has provided a wealth of contributions to the study of competition between firms, yet most strategic management theories were developed and refined for large firm contexts. This suggests the assumed theoretical relationships between strategy preference and performance may break down in the small business setting.

Design/methodology/approach – The paper uses a data set from the National Federation of Independent Businesses to test hypotheses relating the strategy preferences of 754 small firms with the performance outcomes of survival and expected growth.

Findings – Small businesses can focus on both survival and growth when they pursue competency-based strategies, but they risk their very survival when pursuing flexibility-based strategies. Virtually all small firms pursue strategies to compete, but some of the strategies they follow to pursue growth endanger their survival.

Research limitations/implications – Because of life-cycle and resource endowment factors, researchers should carefully parse differences between large and small firms when studying the relationship between strategy preferences and organizational performance.

Practical implications – Small business owners should be aware that their choices of strategies to pursue growth may lead to unintended consequences, such as the demise of their firms.

Originality/value – The paper demonstrates to researchers and practitioners how strategic preferences that presumably allow larger firms both to survive and grow do not have the same effects for smaller firms. The paper establishes boundary conditions for the effectiveness of flexibility strategies on performance in terms of firm size.

Keywords Entrepreneurship, Small business, Competency-based strategies, Firm growth, Flexbility-based strategies, Strategic choice

Paper type Research paper

Virtually all businesses start out small (Aldrich and Auster, 1986), yet there are clear distinctions between small entrepreneurial firms and small "non-entrepreneurial" firms. Schumpeter (1934) argued that entrepreneurial firms were different from other firms because of their pursuit of different combinations of means of production. Small entrepreneurial ventures are valued for their contribution to economic development in terms of job creation, industry leadership, and wealth generation (Hitt *et al.*, 2001). In the pursuit of their growth, these firms typically experience a "corporate life cycle"

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involving stages of birth, growth, maturity, revival, and decline (Kimberly and Miles, 1980; Miller and Friesen, 1984). In order to grow and create the most value from their products or services, these firms must engage in the practices of strategic management involving the set of commitments, decisions, and actions designed and executed to produce a competitive advantage and earn above-average returns (Hitt *et al.*, 2001). The essence of strategy is a firm's theory of how it can gain superior performance in the markets within which it operates (Barney, 2001). Meyer and Heppard (2000) go so far as to regard entrepreneurship and strategy as virtually inseparable.

In contrast, the remainder of small businesses is regarded as "independently owned and operated, not dominant in its field, and not engaged in any new marketing or innovative practices" (Carland *et al.*, 1984, p. 358). This distinction recognizes that a person who owns a business is not necessarily an entrepreneur (Martin, 1982) and that his or her business is not growth oriented and therefore unlikely to experience the stages of the corporate life cycle. Moreover, scholars observe that the majority of small firms after their initial start-up are more concerned about survival than growth, especially once they feel established (Gray, 1998, 2002; Storey, 1994) While individual firms are not dominant in their fields, the population of firms in the USA is dominated by small businesses – 99.5 percent of all businesses in the USA meet the criteria of this definition (US SBA, 2007) – yet the literature on small business frequently regards this category of firms as "non-strategic" (Carland *et al.*, 1984; Weinrauch *et al.*, 1991). The term "non-strategic" means that a firm is not actively engaged in the practices of strategic management needed to create a competitive advantage (Hitt *et al.*, 2001), nor is it likely that such firms possess the resources necessary to do so (Carland *et al.*, 1984).

These opinions do not reflect the realities of the competitive landscape facing the majority of small business owners today. A recent study by the National Federation of Independent Businesses (NFIB) (2003) found that most small business owners believe that they operate in highly competitive climates and that these climates are becoming increasingly competitive; and that 61 percent assess the current climate as much more or more competitive than it was just three years ago (p. 1). Therefore, the presumption that there are somehow two groups of small firms – strategic and non-strategic – is simply wrong. Small firms overwhelmingly operate in increasingly competitive environments, despite the liability of insufficient resources for competing and the inability to pursue a competitive advantage (Weinrauch *et al.*, 1991). This situation may only worsen as small businesses remain on the sidelines while larger competitors enter emergent international markets (Leonidou, 2004). Small firms such as retailers also face asymmetric, even unfair environments when they compete against larger internet-based retailers who do not collect sales taxes from customer purchases.

In addition to competitiveness issues, small firms also need to balance survival and growth prospects. Decades ago, Steinmetz (1969) asserted that successful small firms were required to grow, stating that small firms that fail to pass through three critical stages of growth (direct supervision, supervised supervision, and indirect control) will die. Few individuals likely invest precious resources and their time in a small firm with the intention of ultimate demise, so the majority of small firms must aspire to a growth strategy. Yet small firms substantively differ in their competitive behavior from large firms (Brouthers and Nakos, 2004; Chen and Hambrick, 1995; Moen, 1999). In the US airlines industry, for example, small airlines more actively initiate faster-paced but low-key competitive challenges in their strategies than do

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large airlines, but were also less likely and slower to respond when attacked (Chen and Hambrick, 1995). Another example. There is strong support for the notion that: there are "group norms" for small firms vs large firms; and that deviations from these norms hurt performance for both small and large firms (Chen and Hambrick, 1995). Therefore, small firms must necessarily behave differently from large firms in their strategies. Further, the existence of group norms suggests that preferred strategies within the group of small firms are likely to be similar across group members. Unlike their larger competitors who have already experienced growth, small firms face substantial uncertainty about how to balance survival with growth (Gray, 2002). The focal question of this study therefore is "How does a small firm's choice of competitive strategy affect its survival and growth prospects?"

This paper is organized in the following manner. The first section provides an overview of two of the most popular frameworks for strategic management: Porter's (1980) generic strategy of cost leadership and the resource-based view (RBV) of the firm (Barney, 1986, 1991; Peteraf, 1993; Wernerfelt, 1984). The second section explores the important differences between small and large firms and theorizes how these differences might affect the applicability of strategic management theories to small businesses. The third section applies strategic management theory and practice to the small firm context and examines their implications for survival and growth. The final sections present a discussion of the results and implications of study findings for research and practice.

Theory and hypothesis development

Competing strategic management frameworks: cost leadership and the RBV

Cost Leadership Logic of Competition. Michael Porter introduced three generic strategies in his seminal Competitive Strategy text (1980) that focussed on industry structure: cost leadership, differentiation, and focus. Prior to this publication, the prevalent frameworks of strategic management were based on micro-economic transaction cost efficiency and anti-trust, corporate-control (e.g. Jensen and Meckling, 1976; Manne, 1965; Williamson, 1975) explanations of competition. Porter's (1980) research reformulated the economic concepts-related strategy with an emphasis on industry structure (Rumelt *et al.*, 1991).

Porter (1980) argues that firms can only realistically pursue one of the three generic strategies successfully because each of them requires total commitment and supporting organizational structures. The effects of commitment and supporting structures become "diluted" (p. 35) if there is more than one primary strategic approach. The strategy of cost leadership, for example, requires substantial initial investments in construction of efficient-scale facilities, cost reductions from experience and control of overhead expenses, and cost minimization in the functional areas of R&D, sales, service, and advertising. The successful pursuit of a cost leadership position provide a firm with a competitive advantage because that firm can still earn positive returns after competitors have competed away their profits through rivalry (pp. 35-36).

The ability to achieve a competitive advantage through cost leadership requires a high market share relative to competitors, product design features that lend themselves well to ease in manufacturing, and maintaining a broad line of products to spread out costs of production. Porter (1980) also acknowledges that these competitive attributes can be realized only through a heavy up-front capital investment in state-of-the-art equipment, aggressive pricing, and realization of start-up losses in order to gain

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high market share. If an aspiring cost leader can absorb these costs up front, the firm can later re-invest its high margins in the new equipment and facilities needed to maintain a cost leadership position.

In contrast, the generic strategy of differentiation requires the creation of a product or service that is regarded *industry-wide* as being unique (p. 37, emphasis in original). Approaches toward achieving a differentiation strategy involve upscale design or brand image, sophisticated technology, unique product or service features, superior customer service, and/or integrated dealer networks. Achievement of a differentiation strategy provides a firm with a defensible position within the five forces framework because it usually results in loyal customers, higher margins, and greater supplier power. Further, something that is unique industry-wide is by definition difficult for competitors to imitate. This inimitability and advantages listed above provide the differentiator with a competitive advantage. Further in contrast to the requirement of high market share for successful cost leaders, differentiators benefit from the "perception of exclusivity" that is associated with a truly unique product or service and, by definition, negates the need for high market share (p. 38).

RBV Logic of Competition. The RBV helps to explain the conditions under which a firm's resources will provide it with a competitive advantage (Barney, 1991). The RBV (Barney, 1986, 1991; Peteraf, 1993; Wernerfelt, 1984) arose from the need to explain the competitive performance of firms not from the product side, but from the firm resources side (Wernerfelt, 1984). In other words, Porter's (1980) generic strategies focussed on aspects of a firm's products or services that provide a competitive advantage at the industry level, while an RBV perspective focussed on how a firm's internal resources affect that advantage.

In contrast with the emphasis on external analysis in traditional industrial organization economics (Bain, 1959), the RBV emphasizes an internal analysis of the differences in resource endowments across firms (even within the same industry) and explains how these differences can be a source of a sustainable competitive advantage (Barney, 1986, 1991; Wernerfelt, 1984). Resources contribute to competitive performance advantages to the extent that they are valuable, rare, costly to imitate, and non-substitutable. A valuable and rare resource can help sustain a firm's competitive advantage to the extent that the resource is difficult to imitate (Barney, 1991). Sources of inimitability include: the unique historical conditions under which resource bundles are created; a causally ambiguous relationship between the resources and resulting competitive advantage; and social complexity of the resources (Dierickx and Cool, 1989; Lippman and Rumelt, 1982). Finally, valuable, rare, and difficult to imitate resources can be a source of sustained competitive advantage to the extent that there are no strategically equivalent resources, i.e. substitutes (Barney, 1991).

Small firms vs large firms

Virtually all firms must confront competitive pressures regardless of size or goal orientation, which requires each small firm to "focus resources and explicitly or implicitly develop a strategy to (provide it with) a competitive advantage over others" (US SBA, 2007, p. 2). All firms adapt through the interactions of their strategic choices and the dynamisms of their environments (Child, 1972). The strategic choice view emphasizes how firms can construct, eliminate, or redefine certain objective features of their environments, a process that simultaneously constructs new "realities" and delimits future decisions (Child, 1972; Hrebiniak and Joyce, 1985; Weick, 1979). The firm's choice of strategy is strongly influenced by what its leaders believe are its

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"distinctive competences" – those things that a firm does particularly well relative to its competitors (Barney, 1991; Prahalad and Hamel, 1990; Selznick, 1957). Firms choose their strategies based on their perceptions of their distinct competences and how they differentiate them from competitors (Snow and Hrebiniak, 1980). The extent to which a firm emphasizes any particular strategy is a form of strategic intensity (Baum *et al.*, 2001; Reitsperger *et al.*, 1993). Strategy in small firms is distinct from strategy in large firms (Fiegenbaum and Karnani, 1991; Jarillo, 1989). Larger firms enjoy considerable power over their suppliers and customers to the extent that the large firm accounts for the suppliers' sales and customers' purchasing options (Pfeffer and Salancik, 1978; Porter, 1980), and therefore can achieve a competitive advantage over smaller rivals. Larger firms may also use size to their advantage to create local monopolies or substantial barriers to entry for other competitors (Caves and Porter, 1977) or to create isolating mechanisms in the form of control over scarce resources (Rumelt, 1987). Additionally, there is growing recognition in our field of the contributions of middle managers and other mid-level professionals on the strategic choices of organizations in large organizations (Burgelman, 1983; Dutton and Ashford, 1993; Wooldridge *et al.*, 2008).

Small firms do not enjoy these attributes as sources of strategic choice and competitive advantage and must therefore choose from a narrower range of strategic options. The main reasons why small firms frequently fail to grow are because they have scale, scope, and learning liabilities and disadvantages relative to large firms (Stinchcombe, 1965; Welsh and White, 1981). For example, small firms tend to produce a small volume (scale) of a few products (scope) and typically have a limited capacity for acquiring knowledge (learning) (Nooteboom, 1993). Learning from experience is one of the key attributes that allows firms to pursue a strategy of cost leadership (Porter, 1980), and the lack of this capacity prevents most, if not all, small firms from pursuing this approach. Small firms also differ from large firms in that they are often "resource poor" (Gray, 2002; Welsh and White, 1981) and therefore require different approaches to strategy, especially in the early stage of a firm's existence when the two most important issues are survival and growth (Aldrich and Auster, 1986). Following the discussion of the generic strategies of cost leadership and differentiation, small firms will overwhelmingly pursue a strategy of differentiation because they lack the capital and other resources necessary to achieve the high market shares that characterize cost leaders.

As this study shows, however, the paths to these outcomes can sometimes be mutually exclusive. Strategies that are competence based (inwardly focussed) can support both small firm survival and growth. Conversely, flexibility-based (outwardly focussed) strategies that focus on capturing large numbers of customers in a short period of time can lead to substantial growth but also increase the risk of small firm failure. The literature recognizes that small firms are behaviorally distinct from large firms (Acs and Audretsch, 1989; Mills and Schumann, 1985; Newman, 1978; Storey *et al.*, 1987), but these distinctions seemingly disappear when seeking to explain the relationship between small business' strategies preferences and performance outcomes.

Most popular small business strategies

A recent (NFIB, 2003) study found that small businesses overwhelmingly prefer two ways of competing: offering the highest possible quality (87 percent) and providing better service (83 percent). Both strategies are comparatively inexpensive ways to maintain customer loyalty and generate word-of-mouth advertising. Because small

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firms compete in environments where both the opportunities and constraints are different from those in large organizations (Cooper, 1981), the popularity of these strategies is understandable because they emphasize the personal touch and leveraging of individual competencies. Other strategies, such as minimizing the use of overhead or offering previously unavailable goods or services, were preferred by some small businesses and generally ignored by others (NFIB, 2003). The lower use of these strategies can be explained by the observation that they require small firms to possess unique insights about markets and opportunities and/or unique capabilities that other firms lack and tend to be focussed more on attracting new customers than on retaining existing ones. High quality and better service tend to be competence (inwardly) focussed (Barney, 1995), while minimizing resources and offering previously unavailable goods or services tend to be flexibility (outwardly) focussed (Sanchez, 1995). How do these different focusses affect survival and expected growth?

Competence-based strategy: high possible quality

A firm is able to differentiate itself from competitors if it can be unique at something that is valuable to customers beyond simply offering a low price (Porter, 1985). One of the most common ways for a firm to differentiate itself from its competitors is to offer products or services at a higher level of quality. Such differentiation can lead to competitive advantage and superior performance when the price premium for the differentiation exceeds its additional costs (Porter, 1985). The RBV also suggests that in order to achieve superior performance through differentiation, a firm must possess and use valuable, rare, costly to imitate, and non-substitutable resources in its strategy (Barney, 1991, 2001). Because small businesses are resource constrained, they must rely on individual-specific resources to compete against larger firms (Alvarez and Busenitz, 2001). Individual-specific resources can be an advantage for small firms because it is easier for managers to organize their limited resources in ways that concentrate on fulfilling the needs of a small customer base. One advantage of small firms over large firms is that managers of small firms are better able to focus on running a "totally competitive" business with only a handful of employees because their size and control allows adaptability and rapid response (Slevin and Covin, 1995). Previous studies have linked the specific strategies of small firms – a selective focus on price and quality – with subsequent success (e.g. Woo and Cooper, 1981, 1982), but these studies did not differentiate between survival and growth. Since survival is a necessary but not necessarily sufficient condition for small firms success and the preceding arguments, differentiation strategies based on high quality should be positively related to at least minimum levels of sustained firm performance and survival:

> *H1a.* The extent to which a small firm follows a high-quality differentiation strategy will be positively related to survival.

While the ability to provide a product or service that meets minimally required levels of quality is important to all firms, the pursuit of a differentiation strategy based on high possible quality is especially important for smaller, or newer, resource-constrained firms (Upton *et al.*, 2001) because it offers a relationship with customers that few large competitors can match. A strategy of providing the highest possible quality to customers should bolster a small firm's ability to survive because it can lead to customer loyalty that slows it to attract more customers while protecting this reputation-based advantage through its attributes of tacit and difficult to replicate

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knowledge (Szulanski, 1996). With increasingly asymmetric competitive conditions, such as limited resources for internationalization and cost disadvantages compared to internet firms, a strategy based on high quality represents one of the few feasible responses to competitive moves from larger competitors (e.g. Chen and Hambrick, 1995) to pursue growth. Based on these arguments, differentiation strategies based on high quality should be positively related to expected growth:

H1b. The extent to which a small firm follows a high-quality differentiation strategy will be positively related to expected growth.

Competence-based strategy: better service

Another way that a small firm can pursue a competitive advantage is to offer better service (Porter, 1980; Ray *et al.*, 2004), especially if the type and level of service is difficulty for competitors to imitate (Barney, 1991; Prahalad and Hamel, 1990). Similar to the properties of a highest possible quality strategy, firms that focus on offering better service can become competitive through their ability to retain existing customers (Bharadwaj *et al.*, 1993; Porter, 1980).

A differentiation strategy based on better service can be particularly important for smaller, or newer, resource-constrained firms (Upton *et al.*, 2001) as they do not have the resources to build perceived brand awareness and they can only build brand awareness through reputation and word-of-mouth. The product- or service-specific experiences and skills smaller firms have, along with the social capital they develop with loyal customers over time, allow them to be more quality-focussed and responsive than their large competitors (Alvarez and Busenitz, 2001; Slevin and Covin, 1997). Indeed, when customers assess that service quality is high, the customer's behavioral intentions are favorable, which strengthens his or her relationship with the company (Porter, 1980; Zeithaml *et al.*, 1996). Additionally, a strategy of offering better service helps a small firm to develop customer loyalty and reputation-based advantages over other firms. Therefore, a small firm's pursuit of a strategy of offering better service should be positively related to both survival and expected growth:

H2a. The extent to which a small firm pursues a strategy of offering better service will be positively related to firm survival.

H2b. The extent to which a small firm pursues a strategy of offering better service will be positively related to firm expected growth.

Flexibility-based strategy: minimal resources

Most small firms are cash-constrained and tend to rely on minimal resource stocks through the practice of "bootstrapping" (Winborg and Landstrom, 2001). Bootstrapping is a process of using the minimum possible amount of all types of resources at each stage in a firm's growth (Stevenson, 1984; Timmons, 1999). This approach is attractive to small firms because it reduces some of the risk they face in pursuing opportunities while optimizing flexibility (Timmons, 1999). While bootstrapping and cost leadership approaches both emphasize low fixed costs, these two strategies are diametrically opposed in terms of resource commitments and acceptable losses. Porter's (1980) model of cost leadership requires high initial start-up

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investments, aggressive pricing relative to competitors, and a willingness to accept heavy start-up losses in order to achieve the high market shares that make this strategy work. Cost leadership is essentially a "causation" approach to business because it presumes a large market for a product or service and then plans and executes the resource investments needed to reach that presumed market (Sarasvathy, 2001).

In contrast, bootstrapping emphasizes a minimal investment of resources at all stages of operations. With minimal up-front investments in resources, bootstrapping firms can adjust their market focus and resource commitments based on direct feedback from initial customers. Instead of presuming the existence of a large market share, bootstrappers try to identify a small market of customers who will provide feedback on product or service attributes. This approach of "effectuation" relies on the iterative process of minimal investments, highly focussed target markets for product or services, followed by direct feedback from customers. Because of resource limitations, many small firms may find a bootstrapping approach to strategy to be both desirable and feasible.

A use-of-minimal resources strategy also helps resource-constrained firms to keep costs down when they cannot generate additional resources through financial markets (Musso and Schiavo, 2008). Pursuing a minimal resource strategy allows small businesses to experiment more, to remain less visible and transparent to potential competitors (Mosakowski, 2002), and to invest only if conditions are favorable (McGrath, 1999).

These same attributes also mean that bootstrapping firms will remain less visible and transparent to potential customers. Further, pursuing a minimal resource strategy may also be an indication that a small firm does not have any other viable strategy or, worse yet, any idea of whom its initial target market should be. First, financial constraints on small firms signicantly increase the probability of exiting the market (Musso and Schiavo, 2008), so some small firms that minimize their use of resources may be putting off their inevitable demise rather than optimizing flexibility. Pursuing a minimal resource strategy may be a sign that alternative the small firm is unhappy with its performance and is searching for new routines and opportunities (Bromiley, 1991) or that it is experiencing threat-rigidities in response to adverse environmental circumstances (Staw *et al.*, 1981). Under these circumstances a small firms' pursuit of a minimal resources strategy may be a signal that the firm's survival is being threatened.

On the surface a small firms' pursuit of a minimal overhead strategy appears to be attractive for survival prospects because it prevents them from making costly, hard-to-reverse investments in resources that may not pan out. In reality, a small firm's emphasis of a bootstrapping approach will prevent that firm from being visible to customers and may be a signal that the firm has yet identified a profitable customer segment. For many small firms, minimal use of resources may also be a sign of responses to threat rigidity effects, dissatisfaction with current approaches, or a lack of confidence in the ability to satisfy customer needs profitably. Each of these problems poses a threat to survival of most small firms. Therefore, based on these arguments, minimal resource strategies should be negatively related to survival in small firms. This leads to the following hypothesis:

H3a. The extent to which a small firm relies on a minimal resource strategy will be negatively related to survival.

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The presumed negative relationship between minimal resource strategy and survival is based on the lack of knowledge about the small firm's motivations for pursuing a low overhead approach. If small firms pursue a bootstrapping approach as a result of experiencing distress (lack of confidence, lack of results, imminent failure), then they are already unlikely survive. At the same time, the attributes of a minimal resource strategy that make it more difficult for competitors to identify and imitate activities also make it more difficult for the small business to attract resources necessary for growth. The benefits for growth of pursuing a minimal resource strategy are not merely hypothetical; many small business owners indicate that they have been quite successful in identifying and using low-cost marketing strategies and low-cost operating approaches (Ward *et al.*, 1995; Weinrauch *et al.*, 1991). These approaches provide small firm owners with strategic flexibility within the constraints of their limited resource endowments. Therefore, minimal resource strategies should be positively related to growth in small firms. This leads to the following hypothesis:

H3b. The extent to which a small firm relies on a minimal resource strategy will be positively related to expected growth.

Flexibility-based strategy: new or previously unavailable goods or services

Another way in which small firms can engage in flexibility-based strategies is to offer new or previously unavailable products or services to customers. The presumption here is that missed customers have product or service needs that are either not being met or are being fulfilled imperfectly. Customer markets with unfulfilled needs create opportunities for flexible small businesses who can identify these markets and provide superior value compared to incumbent firms' offers (Ardichvili *et al.*, 2003). The challenge for many small firms is not in the identification of these opportunities, but in selling the previously unavailable product or service because demand is initially low and uncertain (Anderson and Zeithaml, 1984). As a result, the market for previously unavailable goods and services has not been validated.

The introduction of new products or services is a two-step process of awareness and adoption (Kalish, 1985) that requires substantial firm resources and time. In other words, offering and selling novel products or services requires changes in consumer behaviors that rarely occur overnight. Offering new or previously unavailable products or services may also pose switching costs that targeted consumers consider to be prohibitive. Further, compared to other strategies such as market penetration, the offering of previously unavailable products or services poses a high risk to small firms who pursue this strategy (Ansoff, 1965; Moreno and Casillas, 2008). These circumstances suggest that a small firm's pursuit of a strategy of offering new or previously unavailable products or services will be negatively related to survival:

H4a. The extent to which a small firm pursues a strategy of offering new or previously unavailable products or services will be negatively related to survival.

While many firms may not be able to realize market adoption of their novel products or services and thereby fail, some may develop a capacity for recognizing unmet customer needs and delivering a product or service the customer values. This capacity allows small firms to develop a loyal customer base and insights into how to develop

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and offer other products or services that the customer values. The company Oxo, for example, developed a niche in the kitchen hand-held tools market with its unique product grip design and expanded the design across several types of kitchen products.

Offering previously unavailable goods and services is one of the primary means for new venture creation (Sarasvathy, 2001). Despite uncertainties about market demand, the innovative proactive, and risk-taking behaviors associated with this strategy are growth oriented (Covin and Slevin, 1991; Lumpkin and Dess, 1996). Despite its riskiness as a strategy for small firms, offering previously unavailable goods and services offers high-potential rewards in terms of revenue growth (Ansoff, 1965; Moreno and Casillas, 2008). Therefore, a small firm's pursuit of a strategy of targeting customers with unmet needs should be positively related to expected growth:

H4b. The extent to which a small firm pursues a strategy of offering new or previously unavailable products or services will be positively related to expected growth.

Methods

Sample

The data for this survey report were collected for the NFIB Research Foundation by the executive interviewing group of The Gallup Organization. Participating firms ranged in size from one to 249 employees. The interviews for this edition of the Poll were conducted between November 20 and December 16, 2003 from a sample of small employers. According to the NFIB's Small Business Poll on competition, the sampling frame used for the survey was drawn from the files of the Dun and Bradstreet Corporation, "an imperfect file but the best currently available for public use" (NFIB, 2003, p. 18). The researchers who performed the data collection used a random stratified sample to compensate for the highly skewed distribution of small business owners by employee size of firm. This was necessary because nearly 60 percent of employers in the USA employ just one to four people; using a completely random sample would yield comparatively few larger small employers to interview (NFIB, 2003).

Consistent with the stratified sample approach, 254 firms in the sample population consisted of from one to nine employees; 200 firms consisted of 10-19 employees; and 200 firms consisted of 20-249 employees. The majority of respondents to this survey were owner/managers (83 percent); respondents also included owners but not managers (6 percent) and managers but not owners (11 percent). Survey respondents had four-year college degrees (35 percent), some college or associates degrees (23 percent), graduate or professional degrees (18 percent), high school diplomas (16 percent), followed by smaller representation from those who either completed vocational education or did not complete high school. Firms in this sample population represented industrial groups across the spectrum of commerce in the USA to include agriculture, forestry, and fishing (3.7 percent); construction (9.3 percent); manufacturing and mining (8.2 percent); wholesale trade (8.2 percent), retail trade (5.2 percent); transportation and warehousing (2.0 percent); information services (2.2 percent); finance and insurance (4.2 percent); real estate and rental leasing (4.3 percent); professional, scientific, and technical services (16.3 percent); admin support services (1.7 percent); educational services (0.9 percent); educational services (0.9 percent); health care and social assistance (3.8 percent); arts, entertainment, or

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recreation (2.3 percent), accommodations or food service (5.3 percent); and other services, including repairs and personal care (11.3 percent). This study used industry assignments as dummy variables to control for industry-level effects on firm survival and expected growth.

Measures

Dependent variables. The dependent variables in this study are survival and expected growth. *Survival* is measured by the number of years a firm has been operating. This measure is operationalized as the square root of the number of years a firm has been operating to normalize the data for linear regression. *Expected Growth* is measured using a five-point Likert scale question asking "Over the next three years, do you expect this business to: grow significantly, grow quite a bit, grow some, stay about the same, or get smaller". Responses were reverse-coded to associate a higher score with higher growth expectations. The use of expected growth as the dependent variable appears in a number of empirical studies (e.g. Becchetti and Trovato, 2002; Coad and Tamvada, 2012; Dunne *et al.*, 1989; Heshmati, 2001) and is appropriate here to capture small firm expectations about the relationship of strategy preference to firm growth.

Independent variables. The independent variables in this study are the types of strategies small businesses might pursue: highest possible quality, better service, minimal resources, and offering previously unavailable goods or services (NFIB, 2003). Each independent variable was measured with a single nine-point Likert scale question in which a value of 1 meant a given strategy plays no part in the business' competitive strategy and a value of 9 meant the strategy comprised its entire competitive strategy.

Controls. This study controls for industry effects on performance using NAICS categories at the one-digit level with dummy variables (Dess *et al.*, 1990; Rumelt, 1982, 1991). Additionally, this study controls for firm size by incorporating the natural log of the number of employees and for past sales growth because recent performance history is likely to have a strong influence on both of the dependent variables of our study, survival and expected future growth. Past sales growth is measured by the percentage change in last two years' sales for each firm using Likert scale values (5 = increased by 30 + percent; 4 = increased by 20-29 percent; 3 = Increased 10-19 percent; 2 = changed 10 percent either way; 1 = decreased by 10 percent or more).

Analysis

This study tests the hypotheses for survival and expected growth (with the dependent variable for survival normalized) using ordinary least squares regression. Results of regression analysis include all control variables and the dependent variables in the first sets of models, followed by tests of each hypothesis step-wise in individual models, and finally followed by full-model tests.

Analysis also included a *post hoc* test to compare a split sample of the firms along the dependent and independent variables used for this study. This step was necessary because non-growing and unprofitable firms tend to be smaller than average (Singh and Whittington, 1975). Therefore, analysis included *t*-tests to see if there were any significant differences between firms of below- and above-average size and between firms of below- and above-average age. This analysis is discussed in the results section.

Results

Table I presents the summary statistics and correlations for all measures.

H1a and *H1b* address the relationship between a highest possible quality strategy small firm survival and expected growth. Model 1a shows that the relationship of this

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Table I.
Descriptive statistics and correlations

	Mean	SD	1	2	3	4	5	6	7
1 Firm age (normalized)	3.769	1.675							
2 Except to grow	3.264	1.108	−0.198***						
3 Strategy – highest possible quality	8.019	1.769	0.007	0.102**					
4 Strategy – better service	7.799	2.049	0.012	0.141***	0.563***				
5 Strategy – minimal overhead	5.873	2.523	−0.069****	0.072*	0.175***	0.207***			
6 Strategy – new/previously unavailable goods/services	4.730	2.703	−0.066****	0.170***	0.170***	0.150***	0.185***		
7 Ln of firm size in employees	3.140	1.273	0.140***	0.082*	−0.006	0.054	−0.118**	0.015	
8 Last two years, real volume sales change	3.177	1.259	0.162***	0.381***	0.080*	0.059	−0.010	0.069****	0.018

Notes: $n = 754$. $^{*}p < 0.05$; $^{**}p < 0.01$; $^{***}p < 0.001$; $^{****}p < 0.10$

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strategy is positively, but not significantly, related to firm survival. In contrast, Model 1b shows that the relationship between a highest possible quality strategy on expected growth is positive and significant ($p < 0.05$). *H1a* is not supported, while *H1b* is.

H2a and *H2b* predict that a small business' preference for a strategy of better customer service would be positively related to small firm survival and expected growth. As with a highest possible quality strategy, Model 2a shows that the relationship between a better service approach and firm survival was positive but not significant, while Model 2b shows that the relationship between better customer service and expected growth was positive and significant ($p < 0.01$). *H2a* is not supported, while *H2b* is supported.

H3a and *H3b* predict that a small business' use of a minimal overhead strategy will be positively related to firm survival and expected growth. Model 3a in Table II shows that a small firm's use of a minimal resource strategy is negatively but weakly related to firm survival ($p < 0.10$). *H3a* is modestly supported. In support of *H3b*, Model 3b shows that a minimal resource strategy is significantly related to expected growth ($p < 0.05$).

H4a and *H4b* predict that a small business' offering of previously unavailable goods or services will be negatively related to firm survival and positively related to expected growth. The effects of this strategy on firm survival and expected growth are presented in Models 4a and 4b, respectively. In weak support of Hypothesis 4a and strong support of *H4b*, a small firm's offering of new or previously unavailable goods or services is negatively related to survival ($p < 0.10$) and positively related to expected growth ($p < 0.001$) (Table III).

	Base model	Model 1a	Model 2a	Model 3a	Model 4a
Constant	3.637***	3.391***	3.436***	3.895***	3.779***
Firm size	0.203***	0.204***	0.201***	0.191***	0.203***
Previous growth	−0.231***	−0.234***	−0.234***	−0.23***	−0.224***
NAICS 10	1.467**	1.485**	1.515**	1.524**	1.461**
NAICS 20	0.459	0.471	0.481	0.497	0.454
NAICS 30	0.642	0.647	0.648	0.735****	0.677****
NAICS 40	0.301	0.313	0.311	0.337	0.347
NAICS 50	−0.03	−0.02	−0.02	0	−0.023
NAICS 60	−0.322	−0.325	−0.309	−0.281	−0.329
NAICS 70	−0.582	−0.576	−0.571	−0.527	−0.549
NAICS 80	0.176	0.182	0.182	0.228	−0.039
1 Strategy – highest possible quality		0.031			
2 Strategy – better service			0.026		
3 Strategy – minimal overhead				−0.045****	
4 Strategy – new/previously unavailable goods/services					−0.039****
95% LCL of main effect B		−0.008	−0.006	−0.072	−0.065
95% UCL of main effect B		0.059	0.060	−0.017	−0.013
Supported?		No	No	Yes	Yes
F	8.881***	8.15***	8.146	8.44***	8.384***
Adjusted R^2	0.095	0.095	0.095	0.098	0.097

Notes: $^{**}p < 0.01$; $^{***}p < 0.001$; $^{****}p < 0.10$

Table II. Results of linear regression on survival

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The analysis included two-independent-samples t-tests on the main variables of this study with a split sample of above- and below-average sized firms and above- and below-average firms by age. There was only one statistically significant difference in values for one variable – minimal use of overhead – between the split samples. The difference in intention to pursue a strategy of minimal overhead use is significantly larger ($p = 0.015$) for below-average sized firms than for above-average sized firms. The absence of significant differences between the split groups along all of the other independent variables indicates that firms of below-average size were no more or less likely to pursue a particular strategy than firms of above-average size. Further, there was no significant difference ($p = 0.287$) between subgroups on the measure for expected growth. The growth expectations of firms in our sample population of below-average size are generally consistent with those of firms of above-average size.

In t-tests comparing oldest firms to youngest firms (± 1 SD) in this sample population, older firms are significantly more likely to expect to grow ($p < 0.01$) and to have experienced higher past sales growth ($p < 0.01$). With regard to different strategies, the only significant difference was for the strategy of unique marketing – the youngest firms significantly preferred this strategy more than older firms ($p < 0.01$). Old firms and young firms did not differ significantly in their preferences for any given strategy.

Discussion

Contrary to the received wisdom on small businesses, this study finds that all small firms engage in some competitive behaviors to survive and grow. Presumed differences between small firms related to firm size failed to materialize in this study. For example, among small firms, the largest and smallest firms do not differ significantly in growth

	Base model	Model 1b	Model 2b	Model 3b	Model 4b
Constant	2.25***	1.912***	1.846***	2.043***	2.044***
Firm size	0.057****	0.331****	0.053****	0.067*	0.057****
Previous growth	0.336***	0.058***	0.331***	0.336***	0.326***
NAICS 10	−0.833**	−0.808**	−0.737**	−0.879**	−0.825**
NAICS 20	−0.33	−0.314	−0.288	−0.361	−0.323
NAICS 30	0.176	0.183	0.189	0.102	0.126
NAICS 40	−0.101	−0.085	−0.081	−0.131	−0.168
NAICS 50	−0.067	−0.053	−0.048	−0.091	−0.077
NAICS 60	−0.096	−0.1	−0.07	−0.113	−0.086
NAICS 70	−0.046	−0.19	−0.176	−0.244	−0.247
NAICS 80		−0.037	−0.034	−0.088	−0.097
1 Strategy – highest possible quality		0.042*			
2 Strategy – better service			0.052**		
3 Strategy – minimal overhead				0.033*	
4 Strategy – new/previously unavailable goods/services					0.057***
95% LCL of main effect B		0.005	0.022	0.006	0.033
95% UCL of main effect B		0.079	0.085	0.059	0.082
Supported?		Yes	Yes	Yes	Yes
F	15.7***	14.696***	15.166***	14.91***	16.113***
Adjusted R^2	0.163	0.167	0.171	0.169	0.181

Notes: $^{*}p < 0.05$; $^{**}p < 0.01$; $^{***}p < 0.001$; $^{****}p < 0.10$

Table III. Results of linear regression on expected growth

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expectations, past sales growth, or strategy preferences, with the sole exception of use of minimal overhead. The smallest firms prefer a minimal overhead strategy at a level that is significantly greater ($p < 0.05$) than the largest firms. Paradoxically, these same firms also expect their pursuit of a minimal overhead strategy to result in growth.

Among small firms, the oldest and youngest do not differ significantly in their strategy preferences with the exception of a unique marketing approach (significantly preferred by the youngest firms). Importantly, however, the oldest differ significantly from the youngest firms in terms of past sales growth ($p < 0.01$) and expected growth ($p < 0.01$). These results suggest that older firms believe they will continue to grow largely because they have done so in the past, rather than based on any particular preference for a strategy. Small firms seem to experience growth as an outcome of survival and age, while an early emphasis on growth-oriented strategies limits the prospects for the small firm's survival.

Empirical tests of the hypothesized relationships between outwardly focussed small firm strategies and the performance measures of survival and expected produced essentially opposite effects that arise from choice of the dependent variable. The use of inward-focussed strategies – highest-possible-quality and better-service strategies – was the only set of strategies that was positively related to firm survival and, while their effects on survival are not significant, they have significant effects on expected growth. Since many aspects of small firms are frequently extensions of their owners (Lumpkin and Dess, 1996), these results suggest that small firms can leverage the individual competencies of the owner (Chandler and Jansen, 1992; Sadler-Smith *et al.*, 2003) as a strategy compared to the other generic strategies. Small firms are quite able to identify valuable and unique resources and capabilities that reside in their individual members and leverage them to their competitive advantage (e.g. Barney, 1991; Chandler and Jansen, 1992; Sadler-Smith *et al.*, 2003).

Implications

All of the small firms in the sample population engage in some form of strategic behavior. This supports previous claims that virtually all firms face competitive pressures regardless of size and that all firms must find a strategies that provide them with a competitive advantage over others (US SBA, 2007, p. 2). Virtually all small firms engage in some form of strategic behavior in the pursuit of competitive advantage, which means small firms can be strategic without being growth oriented or "entrepreneurial" (e.g. Carland *et al.*, 1984; Weinrauch *et al.*, 1991).

Second, pursuing strategies of minimal overhead and offering previously unavailable goods or services are positively related to small firm expected growth, but negatively related to survival. While the results do not support definitive cause-and-effect relationships, it is possible that firms which pursue any of these strategies either have substantial abilities to engage in those approaches or are just lucky (Barney, 1986; Hannan and Freeman, 1977). This leads to the third major point.

The results suggest that there is a line of demarcation between small and large firms that separates their abilities to pursue strategies toward the outcome of growth without "betting the farm" (Lovallo and Sibony, 2006), yet we have only begun to peer into its causes. A firm's ability to pursue growth-oriented strategies is limited by the growth potentials of its resource base and opportunity space of its customer markets (e.g. Penrose, 1959). This study suggests, but does not definitively identify, an inflection point in the relationship between small firm's ability to successfully execute most strategies that large firms use and positive outcomes from those strategies.

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Limitations

This study has several limitations that should be addressed in future studies of small firm strategy. First, this study is limited to the data available from the NFIB's National Small Business Poll on Competition (NFIB, 2003), and the questions in the poll developed and validated by NFIB were not originally intended to test directly the specific relationships hypothesized in this study. The data set, however, represents one of the few comprehensive, post-millennial secondary data sets focussed completely on small firm strategies.

Second, the data set is cross-sectional in nature, which prevents the ability to make lagged temporal cause-and-effect connections between small firm strategies and their implications for survival and expected growth. This is likely more problematic for relationships between strategy preference and firm survival and less so for relationships between strategy preference and expected growth. The limitations of the data set regarding its cross-sectional design illustrate how representative panel data on entrepreneurship and small businesses remain difficult and expensive to collect (Gartner and Shaver, 2012).

Third, data from the survey include both objective measures, such as firm age and firm size, and subjective measures, such as expectations for growth and competitiveness of the environment. The concept of competitive environment is defined by both objective and perceived states (Bourgeois, 1980). Managers' perceptions may not be fully reliable because they lack full information about future events, alternatives, and consequences (Augier and Teece, 2009) and their interpretations of the environment can be influenced by their individual cognitions and values (Adner and Helfat, 2003), These factors of the data set could possibly cause the results to be influenced by common method bias (Campbell and Fiske, 1959; Mowday and Sutton, 1993).

Recent reviews have shown that self-reported responses can inflate the correlations between measures (Podsakoff *et al.*, 2003, 2012). Because the data come from a secondary source, recommended remedies for this situation cannot be applied. As with most self-reported surveys, caution should be used in interpreting and generalizing the results.

Conclusion

Competence-based strategies are positively related to both survival and expected growth in the small firm domain, while flexibility-based strategies can negatively affect survival and positively affect expected growth. The results of this study suggest that small firms are much better off when they pursue competency-based strategies that optimize unique skill sets absent in other firms (Barney, 1995). In contrast, when small firms pursue flexibility-based strategies, they may be "betting the farm" (Lovallo and Sibony, 2006) in search of greater growth. Even though most new ventures start with an entrepreneur's unique insights into a market opportunity (Sarasvathy, 2001), small firm owners and managers need to identify what unique competencies they can apply to the pursuit of the opportunity that other firms cannot (Barney, 1991, 1995). After establishing routines that allow customers to experience the value of the owner or manager's competencies, small firms may be better off maintaining an inward focus rather than continuing to maintain an outward focus. Because of resource constraints, most small firms may find it too difficult to identify and acquire the flexible resources necessary to pursue different courses of action under changing environmental conditions

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(Sanchez, 1995). This reality may explain why so few firms experience long-term growth and why the majority of small firms remain small.

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