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Recessionary consequences on small business management and business development: the abandonment of strategy?

- *Based on original research, this article examines what small and medium sized enterprises are doing in the face of the slow down of the UK economy.*
- *The sample was drawn from companies identified in a previous survey as having a commitment to strategic management.*
- *Despite the prevailing decline in the economy a large number had either increased sales, or increased profits despite a decline in sales.*
- *The article explores some of the actions taken. Copyright © 1999 John Wiley & Sons, Ltd.*

Every recession has several distinct phases. At first there is disbelief characterised by the view that nothing can possibly dislodge the economy from its healthy growth path. Then there is denial: even as the gloomy evidence accumulates, people look desperately for glimmers of light. Finally, there is blind panic … We are certainly capable of talking ourselves into this last phase.

David Smith
Sunday Times, 13 December 1998

We don't know for certain that this is going to be a hard landing, but small firms should have plans ready even if they are not yet implementing them.

Andrew Godfrey
Partner, Grant Thornton Accountants,
September 1998

There are no substitutes for strategic thinking. Improving quality, price or service is meaningless without knowing what kind of adjustment is relevant in competitive terms. Entrepreneurship unguided by strategic perspective is more likely to fail than succeed.

Michael Porter
The Economist, 23 May 1987

Overview

The above assertion from Porter was right then, it is right now, and it is likely to continue to be right for as far into the future as we can see.

The converging forces of globalisation, technology, deregulation, economic restructuring and the present threat of recession in many parts of the small business sector, make strategy and strategic thinking an essential prerequisite if business survival is to remain on the agenda for many entrepreneurs and owner-managers.

This paper examines the actions and responses of a sample of small firms in the Midlands currently facing adverse trading conditions or the threat of recession, that in an earlier study conducted by one of the authors (Beaver 1997) described themselves as **practitioners of strategic management**. Whilst there is no guarantee of immunity for any business from the effects of deteriorating economic conditions, it can be expected that those firms that engage in strategic management, better understand and respond to the changing nature of industry positioning and competitive advantage, and make timely and appropriate adjustments to preserve, or enhance their market position (Bracker *et al.* 1988; Jennings and Beaver 1997).

Put another way, it is generally well accepted that sub-optimal performance and potential business failure are closely correlated with a lack of attention to business strategy. It follows therefore, that those firms facing tough trading conditions should not only fashion their competitive responses in accordance with any contingency plans that may have been developed, but act in a positive and timely manner to underpin their chosen strategic position.

Given that many small businesses experience a measure of *disadvantage* (Beaver and Harrison 1994; Jennings and Beaver 1996/1997), due not only to the size of the enterprise, but also to their resource-base and operating context, the need to embrace strategic management thinking and actions *especially in a recessionary environment*, has never been more necessary.

Introduction—the economic evidence

With the exception of two or three sectors that fall in the comfort zone, nobody will really be safe. There is an urgent need to develop defensive strategies but too many small firms appear to remain complacent about the effects of a hard landing. Price Waterhouse Coopers (Economic Report, October 1998).

British economic growth is now confirmed to be slowing and the recently published Lloyds TSB research covering 2000 medium-sized businesses, shows very convincingly that the slowdown is gathering momentum. Furthermore, it is not just affecting exporters and the manufacturing sectors (usually thought of as the first to suffer), the 'pain' is filtering through to many parts of the service sector.

The BDO Stoy Hayward 'survey of surveys' suggests that the gloom is now so widespread that many business people will be surprised if the economy is *not* in recession next year and possibly the year after. Its latest findings point to a year-on-year GDP decline of nearly 1% by mid-1999. Interviewed for the 'Sunday Times' (13 December 1998), Stephen Bourne, a Partner with BDO stated;

> *Unless business expectations are significantly out of line with reality, our research shows that British businesses can expect to be in a full-blown recession by the middle of next year.*

A new index of companies in distress, (the so called 'agony index') compiled by the Mandis Group of Nottingham on the basis of profit warnings, job losses, downbeat trading statements and cuts in investment, shows that twice as many firms were experiencing serious problems (December 1998), as a year ago.

Twice as many firms were experiencing serious problems

The research covers approximately 100,000 companies from a wide range of industries and sectors. The figures include organisations where the problems are only just surfacing, as well as those in the depths of crisis. At the time of writing, two pieces of research show quite conclusively that small firms are either in, or preparing for, tough times. Nearly two-thirds (63%) of those polled by Barclays for its small business bulletin expect a trading downturn in the next eighteen months. The quarterly survey from National Westminster showed that more firms reported an annual sales downturn than an improvement for the first time in five years.

During the past six months, all sectors of the UK economy experienced a slowdown in the growth of orders with retailing particularly badly hit by slower sales. On balance, only 18% of businesses reported an increase in orders over the period, against 29% six months ago. This, when combined with the intense domestic and foreign competition, means that more companies are being forced to cut prices, producing an acute squeeze on profits.

For the first time since the six-monthly Business in Britain survey was launched in 1992, *there has been a negative balance on prices*. Over the past six months 19% increased their prices, while 20% cut them. Consequently, just 3% reported higher profits, the lowest number since the last recesssion. These depressing figures have meant that business confidence has dipped to its lowest level since the last recession with predictions that orders will slow further this year. Despite the slowdown, almost half of businesses are operating at capacity. The downbeat outlook means that growth in investment and employment, which would help to alleviate constraints, has also slowed.

Initially these figures do not make great reading, but compared to the last recession, businesses should not suffer such a sharp decline, many will be better prepared and it is predicted that many will emerge stronger and more competitive. Businesses—especially small firms and their banks, have learnt some harsh lessons from the last recession. As a result, it is hoped that many will be better placed to weather the storm and it is unlikely that there will be so many bankruptcies.

The businesses that set the pace initially and led Britain out of recession in the early 1990s were exporters. In order to discover how a business can successfully weather the present storm, it is important to understand why these exporters were in such a strong position. Manufacturers, badly hit in the first Thatcher recession of 1980–81, realised that to be competitive without a weak currency they needed to be more sophisticated in selecting their markets and that they would have to keep a very tight rein on costs. Unfortunately, this was not the policy adopted by many firms leading up to the early 1990s recession, when the tremendous boom meant that sales went sky-high and there was not such a need to keep a firm eye on costs. There are some signs this time round that those exporters are once again striving to improve their competitiveness.

Recent research on exporting has shown that more firms have lost orders than gained

More firms have lost orders than gained them

them, and that growth in exports is now at its lowest level since the last recession. Only 32% of exporters have increased their orders since January 1998, compared to 36% seeing a fall. However, there is evidence that some firms are countering the effect of the strong pound. Over the next six months, 35% of exporters believe that conditions will marginally improve, against 25% that remain sceptical.

Many small businesses, from all sectors, are becoming more competitive by concentrating on innovative products that sell on the basis of *quality*—not just price. Many are forming stronger partnerships with overseas agents and distributors that can respond to local requirements, and many have trimmed shipping costs and profit margins to maintain sales. According to received wisdom, when the value of sterling does become more manageable, it is hoped that many such firms will become even more competitive.

Meanwhile, the message from the clearing banks is that they have planned for the coming slowdown in various ways: notably, working with their principal business customers to pre-empt problems that would otherwise have arisen six months down the line, and perhaps be too advanced by that point. Over the past two years Lloyds TSB has seen a 15% rise in the number of term loans taken out by small firm customers. This is regarded as a healthy sign because business owners are seen to be planning for the future rather than exhibiting the inevitable knee-jerk reaction of the unhealthy reliance on overdrafts.

This policy of pre-empting funding problems together with a movement towards longer-term planning is defended by the banks on sound business reasons, for

> '*prudent and responsible lending should benefit both customer and lender in the long term when the upturn in business confidence appears*' (Lloyds TSB).

Small business survival characteristics—measures of strategic and operational effectiveness

Small firms that survived the last recession exhibited many or all of the following characteristics:

- They had a firm grip on their finances.
- They examined business forecasts carefully and returned to the original business plan to check principal assumptions made about sales volume and cash flow.
- They reduced the money that debtors owed by implementing an effective credit management system and/or used factoring.
- They considered what purchases to make and deferred risky ones that were not necessary or negotiated better prices, extended credit or quicker deliveries to reduce stock. Many had a pricing plan and took a strategic view when setting price.
- They concentrated on tight stock control, reviewing and identifying areas where efficiency and costs could be improved. Successful firms focused stock control efforts on high-price and high-volume items. They also minimised work in progress and finished goods stocks by making production processes as streamlined as possible.
- Sales and marketing activities were reviewed to increase efficiency and reduce costs where possible, including dropping marginal products and concentrating on the most non price-sensitive products and services.

The research

The original research, on which this paper is based, had as its central objective to investigate the nature, style, value and development of strategic management in a population of eighty-seven small businesses in six industry sectors based in the Midlands. (These being; Construction, Hotels and Catering, Engineering, Textiles, Transport and Business services.)

Over half of the firms interviewed (forty-nine, or 56%) claimed that strategic planning was very much part of their business culture and contributed significantly to management approaches to finance, marketing, employment policy and business development. A surprising number of companies, twenty-five in all (nearly 22%), had a *formal business plan* which was used and referred to on occasions, principally to compare outcomes with intentions and assumptions. Simplifying greatly, a central finding in the original survey, was that the principal value of strategic planning to those firms that practised and valued it, was that they had a framework for their assessments of overall performance, bearing in mind that assessment often triggers the managerial will to improve. In the absence of strategic planning, businesses may be profitable, but planning facilitates comparisons with alternative futures and opportunities. Such comparisons lead to the passing of judgement on a business: its progress can then be described as healthy and growing because *the planning process contains an ideal or management benchmark against which it is measured*. In essence, it was concluded that the most dynamic and progressive firms embraced strategic management, not as a parody of corporate planning in large organisations, but as a way of nurturing their own entrepreneurial motivation towards improvements in processes, innovation and profitability. (It should also be noted that this original survey was conducted during late 1996 and early 1997 when activity throughout most sectors of the economy was generally buoyant.)

Planning facilitates comparisons with alternative futures and opportunities

Methodology

A second research inquiry was undertaken during August-November 1998, directed at 30 of the original firms that claimed to practise and value strategic management. It included fifteen of those businesses that possessed a formal business plan. Semi-structured interviews were undertaken which included questions about the current fortunes, management attitudes and market position of the business. Specifically, the interviews aimed to find out:

- How the recession/economic downturn had impacted on the firm
- The major problems arising as a result of the recession
- What major decisions were taken as a result of the problems and opportunities that surfaced
- The level of satisfaction and confidence with the decisions taken and their outcomes
- The value and contribution of strategic management

The findings

The *age* of the firms ranged from three years to sixteen years.

The *employment profiles* were: *Six* had between five and ten employees; *Ten* had between eleven and twenty-nine employees; and *Fourteen* had between thirty and fifty employees. The *sales turnover* ranged from £165,000 to £7.8 m with *eleven* of the businesses claiming to have experienced an increase or a marked increase in turnover in the last year. The remaining *nineteen* firms reported that their sales had remained static, (*nine firms*) or had decreased, (*ten firms*) with *seven* admitting to being very concerned over the fall in the level of demand for their products and services. (Interestingly, none of the firms that had a business plan fell into this last category.)

Quite obviously, the current recessionary climate in the UK continues to have a profound effect upon the small business sector as well as the economy as a whole. The above results show without question that the majority of businesses in this study have experienced either a fall in sales revenues (some more serious than others) or have zero growth on their immediate agenda. However, that is only part of the picture, for a significant minority (nearly 37%) have reported an increase, or *a substantial increase in the demand* for their goods and services. Any recession in a mixed economy does not usually strike indiscriminately, for some industries and markets are more affected than others are. *But these results do not reflect or endorse the evidence and reporting rhetoric of the previous section.* A number of explanations could be advanced here to account for the unusual buoyancy of the businesses—such as some of the firms being blessed with a surfeit of good luck, sectoral advantage or atypical cost profiles. For example, enjoying the protection of a large customer or trading partnership; being located in a recession-proof industry, or having an artificial or synthetic cost structure like many of those found in family-managed businesses. However, there is no evidence to suggest that these or any other mitigating explanations are present. It should be remembered of course, that this is not a representative sample or cross-section of either the small business sector (which if anything, is characterised by its heterogeneity), or the economy as a whole. The firms participating in this research have previously been identified as those that engage in strategic management, which to quote Moss Kanter (1989), 'is an uncommon commodity'. Perhaps therefore, it should come as no real surprise that a significant number of firms in the sample are bucking the current trend of recessionary malaise. Many of them have progressive and professional management, capable of the foresight and ability to anticipate the deterioration in trading conditions and take timely and appropriate remedial action of the kind mentioned above.

Of those firms reporting that their sales were either static or decreasing, *eight* firms had either *maintained or improved their profitability.* By anticipating the arrival of difficult trading conditions, many had profiled their customer base and sought to eliminate marginal accounts and persistent late payers. Furthermore, they had reduced the money owed by debtors by having effective credit management procedures in place with a good knowledge of when to expect payment for their key customers. A statement from the manager and principal owner of one such business summarises both the attitude and approach in a nutshell:

> *Turnover is down a bit but profits are good and getting better. We are having to work hard to maintain our position, but we saw this coming and this represents a disappointment not a disaster. We're a tight outfit with good products and good people. We'll get by—no problem.*

Two of the firms had employed factoring houses to remove the time spent on credit control and chasing debtors. While admitting that this facility cost money, both companies justified their decision by stating that cash flow had improved and a core business function was now professionally executed leaving them free to concentrate on other value-adding activities. A statement from one of the firms summarises the position nicely:

> *The business was a marketing company not a debt collector and the simplest way forward as a small company was to give our debts to someone else. Factoring our debts helped us because we could then forget about them.*

Those firms that were reporting increases, or substantial increases in demand, had in place many of the strategic and operational measures referred to above—but shared three key characteristics. The first was that the **capital structure** of the business was based on longer-term sources of finance (usually with equity funding in place) which provided the stability to plan ahead and provide sufficient flexibility to cope with contingencies, irrespective of the recession! The second, was the inherent understanding in the **value of competitive positioning** and specifically a deep, almost encyclopedic knowledge of what customers want, expect and would be prepared to pay for. This is very similar to one of the principal conclusions from Storey's (1998) research on 'The Ten Percenter's' where he states; 'Success can be attributed to a genuine understanding of customer needs and a determination—almost regardless of cost—to satisfy that requirement.' The third centered around a sense of **focus, enterprise and cohesion**, where clear values articulated by top management and a common purpose for all constituted the business culture. **This evidence suggests that strategic planning and thinking was *not* abandoned under the pressures of recessionary conditions as the title of the paper suggests, rather it was alive and well and delivering superior business performance!**

What then were the problems and characteristics of those firms that reported trading difficulties? Had they failed to predict and appreciate the severity of the recession and its likely consequences and take the appropriate action, or were there other factors to be taken into consideration? It is tempting to conclude that their strategies had failed, either in formulation, implementation or both—but that is probably naïve, unkind, oversimplistic and inaccurate. Any severe economic downturn inevitably produces business casualties irrespective of the degree of management competence or sophistication in corporate strategic posture. Recession exacerbates business weaknesses and pressures that in good times are either condoned or overlooked; it induces panic and frustration in managerial decision making and it exposes deficiencies in organisational responses and capabilities. An earlier research study of the effects of the last recession in Northern Ireland (Brennan and McHugh 1992) had as one of its conclusions that:

> *The respondents are running businesses over which they appear to have little control and this, coupled with increased levels of stress, is eroding the self-confidence and independence traditionally associated with the entrepreneur. Results indicated that the majority of firms are experiencing not only the financial effects of recession, but also an increased feeling of isolation, increased levels of stress, and lowering of self-esteem and emotional stability.*

There is considerable evidence to suggest that those firms experiencing difficulties are just surviving, waiting for demand to improve and carry them in a sales-led bubble back towards relative prosperity. Moreover, it is quite clear that there is nowhere for these businesses to go except upwards—in other words to improve sales and overall performance. To admit otherwise would be tacitly to accept defeat, which no self-respecting entrepreneur and his management team would care to do. The socio-psychological pressures to 'stay with it' are immense. Obtaining accurate information about the current performance and future prospects for these companies is constrained not only by the sensitivity of the information about sales and profits, but also by psychological pressures to deny that things could get any worse. Indeed, it has been our experience in this and other research studies that many small enterprises will be tempted to report optimistically on their financial status and profitability, since to do otherwise would force them to confront their own business mortality.

Clues to the real performance of these and other firms, are best found in the way the organisation functions and its management manages; in its sales and marketing activities and its concern for quality and effectiveness—as revealed in the behaviour of its people and the appearance and age of its physical assets. The tell-tale signs of corporate good or bad health are generally there for all to see if the researcher knows what to look for.

It would seem that the contribution of strategic planning for these firms is, at best, an indifferent one. Perhaps strategic management was characterised more by managerial lip service rather than real intent, enthusiasm and commitment, with the effects of a harsh trading climate taking its inevitable toll. This is not the vehicle or occasion to present a catalogue of their managerial and organisational shortcomings. Whatever the cause of the current misfortunes, there should *not* be any saga of management ambivalence towards strategy when its need has never been greater.

Strategy must never *be abandoned*

Strategy must *never* be abandoned. Indeed, there has never been a more urgent need to embrace a strategic agenda.

Case illustration of good recessionary management. The Sea-Band company

Anyone who suffers from travel sickness will probably owe a debt of gratitude to the Sea-Band company, for this is the business that makes the elasticated wrist-bands that help combat nausea and make travel a lot more pleasant for thousands of people.

The firm was started in the mid-1980s by Barry Jackson in Hinkley, Leicestershire and seemed to prosper from its inception. Like many other entrepreneurs, who set up in business during the 'enterprise-years', Jackson began by expanding aggressively. However, unlike many of his contemporaries that became casualties of the recession in the early 1990s, Jackson is still prospering. Sea-Band now enjoys annual sales of over £3 million and commands a strong British presence in chemists such as Boots, and an 89-strong sales team covering 50 countries, including the USA, where virtually every drug chain and wholesaler carries its products.

Sea-Band's survival stemmed from careful planning and taking measured advice at the first signs of an economic downturn. Jackson states that: '*Early on last time we realized that we were a marketing company and that was where our expertise lay.*' Instead of attempting to carry on with business as usual, Jackson decided that he had to rationalise and jettison those non-core functions that distracted him from the focus of the business. He states;

> *The business was not a debt-collector and the simplest way forward as a small company, was to give our debts to someone else. Factoring our debts helped us because we could then forget about them.*

The company took the factoring route to remove the time spent on credit control and chasing debtors. Factoring (essentially, the selling on of debts or invoices to a collection agency at an agreed rate) cost the business some profit, but it secured cashflow. As a consequence, Jackson then felt free to concentrate his efforts on developing the company. He recognised that the way ahead lay in spreading the risks, and for the business that meant moving into overseas markets so that the company could be free from over-reliance on the home market. However, simply becoming an exporter was not of itself a sufficient answer. Sea-Band needed to sell efficiently in international and ultimately, global markets. At the time, fax machines were relatively new but Jackson recognised that this facility would enable the company to sell overseas without the expense of having a sales team in place. Furthermore, faxing was cheap: it had low running costs and a modest capital outlay—but the benefits were immediate and substantial and enabled Jackson to develop a network of distributors and agents for the Sea-Band products. To quote Jackson: '*I liked the idea of going global at the time. Britain was important to us but it was a limited market, so I tried to spread as much as possible.*'

Unlike many entrepreneurs, Jackson was shrewd enough not to over-expand his operation, or to overreach himself by borrowing too much from the bank. He states: '*We kept lean in the early days, and that stood us in good stead later on.*' It meant that the company developed a strong relationship with its bank and relied on a modest overdraft rather than an unrealistic one that the bank could call in should the company falter.

By 1992 Sea-Band was in relatively good shape, but even though the economy had begun to grow again, Jackson still kept the company lean. It has eight direct workers, a relatively small sales network and no large overheads like factories. The result is that sales are up by 20% on last year, with much of the growth coming from its operations abroad. The continuing success of the business is due in no small part to careful forward planning, which Jackson states other owner-managers have also learnt is essential if they are to continue to do well—indeed, in the present economic climate, if they are to survive. Says Jackson;

> *The difference between the early 1990s and now is that firms are generally much more efficient as well as leaner. A lot of firms went to the wall during the late 1980s and early 1990s because of the recession, but also because of poor management.*

This time round, Jackson is confident that the economic downturn will have less of an impact but he acknowledges that there will be casualties. One of the consequences, he says, will be higher unemployment as firms slim their workforces to carry on trading or freeze them at current levels. Sea-Band is already feeling the adverse effects of the strong pound, but the measures that Jackson has in place, combined with the experience he had trading through the last recession, should ensure that he survives a hard landing.

'*We are not lowering prices*,' he says '*but we are improving the level of customer service by providing extra value*.'

Jackson monitors the financial trends very closely. '*We can jump on things pretty quickly in terms of our accounts so we can put something right in a maximum of six weeks*,' he says. '*Not everything is perfect, but we are reasonably happy*.'

How to survive a recession—practical managerial guidance

Business plan

Examine the business forecasts carefully and return to the original plan to check on the assumptions made about sales volume and cash flow. Check that all the proposed expenditure is necessary.

Cashflow

This is the key area—the management of cash flow is the lifeblood of any business. Is the working capital sufficient for projected activity? Examine areas such as the purchase of new equipment, machinery and vehicles—and consider alternative approaches such as leasing to free up cash.

The bank

Review the relationship with the bank to ensure that things are on a sound footing. Banks have learnt much from the last recession and know that if the firms that they lend to do not prosper then neither will they. Recognise any problems at an early stage and inform the bank as soon as possible.

Banking costs and charges

Substantial savings can be made on banking charges, so it is advisable to check whether the cheapest methods are being used, such as automated payments or payments over the telephone. Avoid unarranged overdrafts or exceeding agreed overdraft limits. Review insurance costs and other financial charges.

Pricing policy

Check to ensure that prices will be sustainable and whether the profit margin(s) will be sufficient if the volume of sales falls. If not then review the sales and pricing policy. Try to eliminate any sales where margins are already borderline.

Overheads

Scrutinise the costs that do not vary with output—areas to focus on include rent, rates and local taxes and utilities (the competition in the utilities sector at the time of writing has never been as intense, so take full advantage). Examine plant, equipment and staff costs with the objective of cutting overheads. Consider making salaries less fixed and more dependent on performance.

Competition

Examine the nature, health and responses of identified competition. How are they faring? Valuable ideas and suggestions for dealing with tighter markets may well result.

New customers

Credit checks can be done quickly and are relatively inexpensive. Always check the credit status of a new customer and review the status of existing customers on a regular basis.

Marketing

A natural extension of the above point but worth thinking about in a strategic manner as marketing costs can be considerable. Attempt to improve the effectiveness of marketing and sales by reviewing the costs and margins of company products and services. Consider dropping unprofitable products and limit selling efforts to the most profitable ones.

Credit limits

Always attempt to establish how big orders will be and how often they will be placed. Set a credit limit for each customer and stick to it. For new customers, set a modest credit limit and only gradually increase it if they show that they pay on time. ***Never* give unlimited credit.**

Terms of sale

Terms of sale should always be stated on order acceptances, invoices and other documents that govern the trading relationship(s). Include a provision for adding interest to the outstanding amount to encourage payment on time. Be aware of the company's legal entitlements under the late payment of commercial debts act.

Overdue accounts

Send out statements on a monthly basis and chase up overdue accounts on the telephone. Do not wait until the end of the month if you can send out invoices at the same time as you send out the goods. Be firm with slow payers and always send reminders by first class post to promote a sense of urgency.

Administration and records

Always ensure that invoices are correctly addressed, relate to the goods delivered and include order numbers if they are required. Make frequent and regular checks to ensure that all details are up to date and accurate—in short—be as professional as you can.

Suppliers and stock

If your company is relying on two or three main suppliers, consider what would happen if alternatives had to be found. Consider negotiating discounts for prompt payments or better terms to keep your cash for longer before paying bills. Review stock levels and talk to suppliers about the possibility of more frequent deliveries to keep stock levels low. Check to see if old lines can be sold off and consider discounts for slow moving items.

Factoring

Investigate the possibility of using a sales-linked finance organisation that has the systems and resources to improve cash flow and will cut the time devoted to credit control. Finally, the key to ensuring that the business is prepared for a slowdown is to prioritise. *Put cash flow first; profit second and sales third.*

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