The strategy payoff for smaller enterprises

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Strategic management is a central concept in modern management practice. This paper examines business strategy from the small firm and enterprise development perspective. The value of a well-considered and well-defined strategy for the venture is advocated for superior business performance and the ways in which entrepreneurs can devise, control and communicate strategy is considered here.

Small firms at odds with strategic planning

Strategic management as a field of study typically deals with large and established businesses and their relationship with their market environment and operating context. However, knowing where the business is going, together with the opportunities and routes available to get it there, is as important to a small enterprise as a large one. Despite the importance and growing recognition of small firms and entrepreneurial ventures and their contribution to economic vitality, employment generation, innovation and business development, the value and importance of strategic management and thinking to the small firm community has only been recognised and acknowledged comparatively recently. Despite the contribution and significance of small firms, however, every year tens of thousands of small enterprises fail or cease trading. According to the US Small Business Administration, some 25 per cent fail within two years and 63 per cent fail within six years. (SBA, 2005). Similar rates of failure occur in the UK, Holland, Ireland, Japan and Hong Kong. Although some studies indicate that the survival rate of new enterprises is higher, small businesses are definitely risky. The causes of small enterprise failure (depending on the study cited), range from inadequate accounting procedures to the inability to manage growth (Beaver, 2002; Beaver and Stewart, 2004).

The underlying problem appears to be an overall lack of strategic management skills and abilities, beginning with an inability to articulate a strategy to reach the customer(s) and ending with a failure to develop an adequate system of performance measurement and control. According to a much cited study of small business failures:

> In nearly all cases, the practice of strategic planning by small firm owners and managers was found to be scanty and perfunctory (El-Namacki, 1990).

Contemporary research has shown repeatedly that strategic thinking and planning is strongly related to small business financial performance. This has been confirmed by a recent study of small firms in the UK Midlands (see Beaver, 2002), which showed quite conclusively that strategic thinking is an essential ingredient in enterprise survival, performance and growth. It is important here to again distinguish between a small firm and an entrepreneurial venture, as the concepts and operating realities are frequently very different:

- The small firm is independently owned and operated, not dominant in its field, and does not engage in innovative strategic practices.

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- The entrepreneurial venture, by contrast, is any business whose primary goals are profitability and growth and that can be characterised by innovative strategic management practices.

The basic difference then between the small business and the entrepreneurial venture lies not in the type or nature of the products and services provided, but in the fundamental perspectives on innovation, growth and business development. Indeed, many commentators and researchers have noted that strategic management is more likely to be an integral part of an entrepreneurial venture than of the ''typical'' small firm and that it is the approach to planning that separates the entrepreneur from the small business owner-manager. Yet many small enterprise managers and practitioners still refuse to embrace the strategy process, with four reasons usually cited for the apparent lack of strategic management practice in both new and established small firms:

1. *Not enough time*. Day-to-day operating issues and decisions absorb the time necessary for long-term planning. Avoidance of strategic management is justified on the basis of everyday operational and administrative decisions, which by their nature may be complex and demanding and often leave little time for anything else.
2. *Unfamiliarity with strategic management techniques and process*. The route into small business management may make the owner-manager distrust or reject the value of strategic planning – and it does not (usually) have a short-term pay-off, which may go against the mind set of many practitioners, especially if resources are limited.
3. *Lack of skills*. Many small firm practitioners perceive strategic management as complex and demanding with limited applicability to the operating context of the enterprise. Small business managers often lack the necessary skills and confidence to begin strategic planning and lack the motivation or resources to commission consultants or outside assistance. The small business support infrastructure may also lack the calibre and experience of suitably qualified individuals to advise on strategic matters.
4. *Lack of trust and openness*. Many small firm owner-managers are very sensitive about business information (especially financial matters) and are unwilling to share strategic planning with employees or other stakeholders. For this reason also, boards of directors (if they exist) are often comprised of close friends and relatives of the owner-manager – people unlikely or unwilling to provide an objective viewpoint or effective professional advice.

But in practice the entrepreneur is a strategic manager as he/she, at least initially, makes all the strategic and operational decisions. All three levels of strategy – corporate, business and functional – are the concerns of the founder and owner-manager of the enterprise. Indeed, entrepreneurs are strategic planners without realising it!

Strategy defined broadly

The notion that an organisation has a strategy lies at the centre of much contemporary management thinking. A strategy can be defined as the actions an organisation takes to pursue its business objectives. Strategy drives performance and an effective strategy should result in a good performance. An organisation's strategy is therefore multi-faceted. It can be viewed from a number of perspectives depending on which aspects of its actions are of interest. A basic distinction exists between the content of a firm's strategy and the strategy process that the business adopts to maintain and succeed with that strategy.

The strategy content relates to what the business actually does while the strategy process relates to the way the business decides what it is going to do. The strategy content has three distinct decision areas:

1. the products and services to be offered;
2. the markets to be targeted; and
3. the approach taken to secure and retain competitive advantage.

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Applying the above to the operating context of the small business, it is first necessary to understand the motivations of the owner(s) or principal stakeholders of the enterprise, since the two are frequently indistinguishable – certainly in the early days of the firm’s start-up. The pressures and reasons which determine these objectives may well embrace personal lifestyle and family considerations as well as commercial ones. Further, the entrepreneur often starts the business with the declared intention of becoming independent and, once established, may have a clear intention of maintaining this independence by keeping day-to-day operational control.

To achieve this, the strategic goal may become one of no growth or of minimum growth consistent with survival and an acceptable level of financial reward. Moreover, the choices that are made may take into account personal lifestyles, interests and family considerations. To the outside observer, this can produce a company with a very strange profile but one that is, in fact, pursuing a strategy, which is internally consistent**.** As the operating environment changes over time and adjustments are made to preserve and enhance competitive vitality, the owner-manager or entrepreneur may be forced to consider issues of retirement, divestment, succession and family considerations and personal objectives may change. Despite the needs of the business or indeed, priority may well be given to the desires and skills of the family members, perhaps to continue the family name in the firm and to provide continued employment for a loyal workforce.

The list of possible outcomes and consequences here is considerable, but what is clear is that the goals and direction of the business may need to change. Ownership and control of the enterprise, once in the hands of the few, may now become increasingly divorced and fragmented and the complexion of the business, together with the strategic choices being made, may bear little resemblance to the original venture.

The formation and development of strategy in the smaller enterprise can be more easily understood if a simple illustration is made comparing the management, ownership and competitive environment of a large organisation:

1. *In the large organisation*:
   - The chairman and chief executive officer are appointed on the basis of their corporate track record and credibility with the ‘‘City’’ and principal stakeholders and shareholders. Political skills and the ability for holistic thinking are essential attributes.
   - There is a requirement to balance the various, and often competing, requirements of stakeholders. The stakeholder web of the organisation is driven by economic, social and political considerations.
   - Strategic choices and actions are invariably driven by managerial motives and ambitions that may be at variance with preferred shareholder choice(s).
2. *In the smaller enterprise*:
   - The owner-manager or entrepreneur is the principal stakeholder and ultimate strategic manager. Usually, there is little separation of ownership and control.
   - Personal, family and lifestyle considerations dictate strategy, which may be at variance with conventional economic criteria. Managerial competence and independence may deliberately curtail business development and ambitions may be limited or modest.

- Notions and perceptions of business success are dependent on the owner-entrepreneur's orientation towards the enterprise and can be expected to change over time.

Entrepreneurs and owner-managers inhabit a very different world from that of their counterparts in large organisations. They frequently have limited resources to draw upon and operate with the knowledge that the difference between success and failure can be their willingness to risk all their personal possessions in a venture and to work extremely hard. However, a well-defined and well-communicated strategy can help the smaller firm to succeed whatever its principal goals and ambitions happen to be.

When an enterprise has invested in developing a strategy that is both realistic and achievable and has communicated it to stakeholders, there are many benefits that typically follow from the strategy:

- it encourages the entrepreneur to assess and articulate their vision;
- a strategy provides the starting point for setting objectives;
- it acts as a guide to decision-making;
- a strategy guides the organisation and design of the enterprise and relates it to the operating environment;
- a strategy illuminates new possibilities for business development; and
- a strategy acts as a common language for stakeholders.

In concluding this section, the following points distilled from contemporary research evidence are noteworthy:

- Entrepreneurial ventures and small enterprises are for the most part managed far less formally than are large, established business organisations. Small firms with designs on rapid expansion and growth tend to follow the entrepreneurial mode of strategy formulation, characterised by bold moves and intuitive decisions.
- Small businesses that engage in contemporary strategic management practices tend to outperform those that do not. However, this does not mean that formal procedures are either necessary or desirable, although some organisational regularity is recommended. The process of strategic thinking and planning, rather than the plan itself, appears to be the key driver of business performance.
- Small firm practitioners appear to make little distinction between strategy formulation and strategy implementation.
- In many small companies, evaluation and control procedures are usually rather informal and reflect the owner/entrepreneur's preferences. Many small firms are often run on a cash basis and have minimum reporting procedures. For these and other reasons mentioned earlier, attempts to measure the strategic health of such enterprises using standard evaluation methods are often inadequate and frequently misleading.
- The success of many new ventures is largely determined by the industry structure, the owner/entrepreneur's skill as a strategist and venture manager and the avoidance of direct competitive retaliation, especially in the early days of business formation. A good example to illustrate this point is the early development of the now global and highly successful Hewlett Packard.
- Successful small firms practice strategic management either consciously and visibly or unconsciously and invisibly!

The common denominators for survivors

Researching small business management performance and the quest for competitive advantage is fraught with difficulties, especially in difficult trading conditions when there is a tendency to pretend that things are not as dire as they really are. The relationship among enterprise performance, management actions (or inactions) and the value and contribution of strategy is extremely tenuous and very difficult, if not impossible, to demonstrate conclusively. Only those persons immediately affected by organisational events have sufficient knowledge of the precise circumstances to be able to suggest cause-and-effect relationships.

Of the research undertaken to investigate those small firms that have survived, prospered and grown, despite adverse trading conditions and radical changes in customer behaviour, many exhibited most 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. Many 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 continually 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 original research on which this paper is based (Beaver, 2002) had as its central objective to investigate the nature, style, value and development of strategic management in a sample of 87 small businesses in six industry sectors based in the UK Midlands: construction, hotels and catering, engineering, textiles, transport and business services.

It was found that over half of the firms, (49 or 56 per cent) 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, 25 in all (nearly 22 per cent), had a formal business plan which was used and referred to on occasions, principally to compare outcomes with intentions and assumptions.

A central finding in this inquiry was that the principal value of strategic planning to those firms that practiced and valued it was 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 passing judgment 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 found 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.

“Small businesses that engage in contemporary strategic management practices tend to outperform those that do not.”

The strategy proof is in the performance

Those small firms that were reporting increases in demand had in place many of the strategic and operational measures referred to above but they all shared three key characteristics:

1. The capital structure of the business was based on longer-term sources of finance (usually with equity funding in place) that provided the stability to plan ahead and provide sufficient flexibility to cope with contingencies, whatever the market vagaries.
2. They had an inherent understanding in the value of competitive positioning and a deep, almost encyclopaedic knowledge of what customers want, expect and would be prepared to pay for.
3. They had a 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 thinking was indeed practised, valued and embraced, – and delivering superior business performance even under the pressures of sometimes deteriorating market conditions. Given the management posture and market profiles of these firms, demand for their products and services was healthy, confidence was high and the internal atmosphere was buoyant and positive.

It is easy to state the obvious – that thinking and managing strategically is an essential pre-requisite of business success and superior performance for all firms, whatever their size, sector or complexion. To do so is to court naïveté and ignore the role and meaning of strategy and its effect on enterprise prosperity. This is not to deny the value and importance of corporate strategy and business planning but rather to appreciate the complexity of the subject matter and its relationship with organisational achievement in the face of possible difficulties in the operating environment.

Throughout much of the literature – especially that designed principally for ''practitioner'' consumption, the terms ''strategy'', ''strategic planning'', ''business planning'' and ''strategic management'' are frequently packaged and used as though they were interchangeable – identical concepts and/or activities. Quite clearly they are not and many writers have taken strong, often entrenched intellectual positions about the notion and meaning of these terms. For the purposes of this paper, this surfaced as a major issue because the majority of small business owners, managers and practitioners that participated in the research had neither the time or inclination to play these ''language games''.

Strategy and planning were for the most part seen as identical and equivalent activities, with only a marginal distinction being made between the nature of business-wide decisions and operational activities. If strategic management is perceived by many as an essential business activity which must increase in sophistication, depth and academic rigour, then this is not the perception of the small business professionals in this paper. For them, strategy is about articulating clarity of managerial thought and purpose properly applied to the resources and operating context of the firm to achieve sustainable competitive advantage. This is tested to the full when trading conditions deteriorate. However, in line with previous comments and observations from other researchers, the strategic planning/management reported here is very different from that found in large companies. As noted earlier, the management processes in small firms are indeed unique. Much of current, contemporary management theory is still founded on the empirical analysis of managerial action in large organisations. These principles, no matter how refined, cannot be applied to the smaller enterprise. Whilst common managerial skills need to be in evidence in many organisational situations, the contextualisation of these skills to meet the requirements of the small business operating context is distinctive.

Whatever term is selected or preferred, ''strategic management'' in the small firms that are referred to here is enacted in a highly personalised manner and is strongly influenced by the actions, abilities, personality and success criteria of the key role players. The successful firms discussed here are adopting a more imaginative approach to risk – a strategic

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approach. In particular, they are using organisational early warning systems to identify problems in the business and trying to assess more accurately the impact on the economy of external events. They have cultures that embrace the need for all members to take active roles in sensing, communicating and acting on environmental change, recognising that this is an essential pre-requisite to continued success.

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Finally, it is worth noting the observation from Porter (1987), offered some 15 years ago:

> 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 to succeed.

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