Strategic Management of Small Firms

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ABSTRACT

Strategic management as a discipline has been evolved only during last six decades but has mainly focused on the large firms. By contrast the literature relating to strategic management within the small firms sector has remained limited. Much of the existing literature has dealt with business planning rather than strategic management, or the process of strategy within the smaller firm. This paper outlines a proposed framework for understanding the strategic management of small entrepreneurial firms and draws upon the literature to illustrate aspects of the proposed model.

Key words: Strategy, Strategic thinking, Small firms, Entrepreneurship, Innovation,

THE IMPORTANCE OF STRATEGIC THINKING

Strategic management is largely associated with the large corporation and most of the theories associated with the subject have been developed for large firms. Small firms are generally owned and led by owner-managers who make strategic decisions based more on pragmatic intuition than academic principles. However, while the lack of formal planning within small firms is recognized, the importance of strategic awareness and personal commitment from the entrepreneur is viewed as having the potential to serve as a counterweight (Gibb &Scott, 1985). The possession of a strategic plan has been advocated as important to the success of small firms, particularly to outline the strategic direction of the firm, coordinate action and assisting achieving goals (Sandberg, Robinson & Pearce, 2001; 2001).

The majority of small firms are led by owner-managers who are strategically myopic. While this may seem a harsh comment, it reflects their lack of long-term vision as to where their company is headed, and their stronger orientation toward operational rather than strategic issues. Such strategic myopia may be attributed to the managerial environment in which many small business owners find themselves; too often they are busy dealing with the daily challenges associated with running their firm to find sufficient time to consider their future strategic directions. However, the ability to think and act strategically is probably the most important attribute an owner-manager can have, and one that is critical to sustained business development. For example, a study of 906 CEOs of Fortune 500 fast growth firms in the United States identified that 86 percent had long-term plans for the ownership of their businesses, 79 percent had formal written business plans and 85 percent made decisions in consultation with their senior management (Sexton & Seale, 1997).

In comparison to the Fortune 500 companies, the majority of small firms lack formal business plans and a coherent approach to strategy formulation. A survey of 500 small businesses in the United States during the mid-1990s found that fewer than 42 per cent possessed a formal business plan (Managing Office Technology, 1994). It has been argued that small business owner-managers do not plan because they lack the knowledge, confidence or skills to do so (Posner, 1985). Research into the impact formal business planning has on small firm performance remains equivocal due in part to the general absence of such planning within the majority of companies. For many owner-managers the absence of formal business planning is attributed to such things as: i) a lack of time to devote to such activities; ii) lack of knowledge about how to plan; iii) inadequate planning skills; and iv) unwillingness to share strategies with others or commit ideas to paper (Robinson & Pearce, 1984).

Research into the relationship between formal strategic planning and financial performance has been unable to offer conclusive support to the benefits of such activity (Pearce, Freeman & Robinson, 1987), however, although the link between formal strategic planning and performance within the small firm is difficult to clearly establish, it would be incorrect to conclude that strategic planning is something appropriate only to large firms and can be ignored by owner-managers (Schwenk & Shrader, 1993).

Formal strategic management practice, such as business planning, has been found to assist start up firms (Castrogiovanni, 1996), and small firms engaged in periods of rapid growth (Robinson, Pearce, Vozikis & Mescon, 1984). Longitudinal research has also found failure rates among small firms that engage in formal strategic planning behaviour is lower than those that do not (Sexton & van Auken, 1985). It appears that what is important to the small firm is the sophistication of the strategic management practice it undertakes, rather than whether or not the firm's owner-manager has a plan or engages in planning (Rue & Ibrahim 1998). Higher growth rates have been found among owner-managers who adopt more sophisticated strategic management behaviour than those with a more informal or intuitive approach (Lyles, Baird, Orris & Kuratko 1993). It could be argued that growth within the small firm forces the owner-manager to adopt more formal strategic management behaviour due to the increasing complexity of the firm's operations (Bracker & Pearson 1986), however, evidence suggests that formal strategic management behaviour is advantageous to small firms experiencing growth (Robinson & Pearce, 1983).

STRATEGY AND THE GROWTH CYCLE OF SMALL FIRMS

Research into the growth of small firms has indicated a series of stage-models in which the business moves through a number of defined stages as it grows (Churchill & Lewis, 1983). While various models identify different numbers of stages, these models generally suggest that the business is initially conceived in the mind or minds of its founders (pre start-up), is then established (start-up) and passes through several additional stages as it grows into a mature large firm. These additional stages might encompass a period of *survival* while the firm struggles to achieve sustainable profitability, *growth* (sometimes divided into early and late stages) in which the firm takes on employees, wins new markets and introduces new products. Once it starts to grow it will either plateau off or enter a further stage of *expansion* in which transitions from a small to a medium or even large firm before reaching maturity (Scott & Bruce, 1987). While the actual growth of individual small firms may not be as linear as such theoretical models suggest, they provide a useful framework against which to analyze the experiences of particular firms. At each stage of the process the small firm can grow, plateau or even die. In the initial stages of formation and survival the owner-manager is largely focused on keeping the business alive and must find new customers and maintain sufficient cash flows to pay running costs. The owner manager is likely to be the most important asset the little firm has, providing all its managerial skill, direction and financial capital. However, such stage models do not adequately explain the process of strategic growth within the small firm or what key elements contribute to the successful development of the entrepreneurial venture.

THE ENTREPRENEURIAL PROCESS

A potential starting point to understand the strategic management process within the small entrepreneurial firm is the three-stage entrepreneurial process. This process starts with the capacity of entrepreneurial individuals to recognize new opportunities and become passionate about exploiting them. This ability to recognize a commercial opportunity has been considered by some academic writers to be more important than strategy, planning, venture financing, team building or networks (Timmons, 1999). Once the entrepreneur has committed himself or herself to their opportunity, they must marshal sufficient resources to see their goals achieved. The essential resources they will need to assemble include the money or investment capital required to launch the business, access to suitable markets within which they can expand, and the managerial competence to coordinate the entire process. The first involves raising sufficient capital to fund their new venture; the second is associated with developing the product or service and then getting it to market. Finally, the management area involves the skills of planning, leading, organizing and delegation required to keep the business operating smoothly. The success of the new venture will depend on the ability of the initiating entrepreneur and their team to attract other stakeholders either as customers, employees or investors (Kourilsky, 1995).

THE ROLE OF ENTREPRENEURSHIP

At the core of the entrepreneurial venture and the initiator of the entrepreneurial process is the entrepreneur. It is important to draw a distinction between the process of small business management and the concept of entrepreneurship or the entrepreneur (Brockhaus, 1987). Entrepreneurs have been viewed in many ways but in this context they are the key agents of change or creativity leading to new growth and opportunity (Schumpeter, 1954). While the majority of small firms are owned and managed by individuals of varying competence, these owner-managers should not be confused with entrepreneurs. In contrast to the innovative, growth oriented and strategically minded entrepreneur, the small business owner-manager is typically defined as focused on furthering personal goals within a venture that consumes all their time and is essentially an extension of their own personality (Carland, Hoy, Boulton, & Carland, 1984). The term owner-manager is generally correct in most small business research (Moran, 1998) however it would not be so for any understanding of the entrepreneurial venture. Competent management within the small firm is a necessary ingredient for success, but it is not the same as entrepreneurship (Penrose, 1959). For entrepreneurial growth the firm requires the leadership of individuals with vision who are focused on growth and profit maximization as principal goals. Under such conditions the entrepreneur is characterized principally by innovative behaviour and will employ strategic management practices in the business (Carland, Hoy, Boulton, & Carland, 1984).

THE IMPORTANCE OF INNOVATION

In addition to the need for entrepreneurial management, the successful entrepreneurial venture needs to innovate to secure for itself a point of difference within its chosen markets (Porter & Stern, 2001). Although the importance of innovation to industry is well recognized, the concept remains less clearly defined with popular emphasis on new technology and radical change (Grupp & Maital 2001:23). Within a business context, innovation is associated with the creation of changes to existing products or processes that can lead to the enhancement of the organization’s ability to offer superior value to its customers (Tushman & Nadler 1986). Of particular importance is the ability of the organization to undertake innovation on a systematic level, producing regular improvements in product or process through the implementation of an innovation management system (Drucker 1985 :31).

The key elements required for successful innovation have been identified as the possession of a market orientation, a management style (structure and culture) that fosters creativity, and a planning process that is non-linear (Quinn, 1985). Research into new product development processes highlights the value of workplace environments that offer project teams a high degree of autonomy, the capacity to determine their own goals and cross-fertilization of ideas, skills and behaviours (Takeuchi & Nonaka, 1986). Also important is the role of leadership within organizations as senior management can both encourage and impede new ideas. Innovation is likely to be enhanced in environments where a strong relationship exists between managers and employees, and where such managerial leaders provide the necessary encouragement to innovative behaviour (Scott & Bruce, 1994).

Innovation in small firms is typically more pronounced than in larger firms, due to the need for small firms to constantly adapt to changing environments. Small firms are well placed to develop close partnerships with customers that define a strong market orientation. The need to respond to customer demands or market opportunities is frequently easier for small firms where strategic decisions are made quickly and with the full support of the senior management who are both chief executives and principal share holders. The informal and frequently chaotic nature of small firm planning is also in keeping with the non-linear framework advocated. Small firms that possess innovative orientations are more likely to emulate the autonomous, multi-disciplinary project teams that are often difficult to generate within larger organizations. However the attitude and orientation of the owner-manager is the key to innovativeness within the small firm (Chandler, Keller & Lyon,2000).

THE NEED FOR STRATEGIC NETWORKING

While the entrepreneur and their innovation are important elements in the initial stage of opportunity recognition, the successful diffusion of the innovation into the market and with it the growth of the entrepreneurial venture, is likely to be constrained by a lack of resources.

Whatever the advantages the new innovation offers it will not succeed without adequate financial backing, marketing and production competencies. These are frequently the types of resources that small firms lack. However, small firms exist within a network of actors consisting of customers, suppliers, financial institutions, government agencies, local authorities, employees, other firms and stakeholders (Jennings & Beaver 1997). The entrepreneurial manager of a small firm can leverage such networks to secure resources that they do not possess within their own organization with resulting competitive advantages (Ostgaard & Birley 1994).

Strategic network relationships operate on three broad levels or layers (Holmlund & Tornroos 1997). The first of these is that of the *production network layer*, which consists of the vertical supply-chain relationships flowing through a particular business activity system. Critical to this are the *key suppliers* and *lead customers* that make up the production network in which the firm operates. Key suppliers are those firms that offer critical inputs to the firm and who would degrade the firm's competitiveness if they allowed their own quality or efficiency to degrade.

Lead customers are typically dominant in their own industries and have above average levels of competitiveness. They assist the firm to benchmark its quality to the highest levels, and consistently drive up performance standards. Due to the dominance they have in their own industry, lead customers offer firms access to new markets and increased sales. Lead customers also serve as a source of new ideas and often collaborate with their suppliers to foster innovation.

In addition to the production layer, the strategic network also consists of the *resource network layer* and the *social network layer* (Holmlund & Tornroos 1997). The first of these comprises those actors that control various resources necessary for the production process to take place.

Typical actors within a resource network are financial institutions (e.g. banks, venture capital firms), insurance providers, transport, storage and communications industries, education and training institutions. It can also include research centres or even firms in other industries that can provide complimentary goods and services or transfer of technology (e.g. packaging technology). The third layer is that of the social interaction that takes place between personnel from the firms within the network. Social interaction can be both formal and informal in nature and has been found to be an important source of innovation due to the sharing of knowledge that takes place (Hogberg & Edvinsson 1998).

The strategic alliances that form the basis of the networks within which small firms operate can range from loose affiliations with limited commitments and relatively little allocation of resources, to tight associations market by amalgamation. Such alliances can take place across both the production network and resource network layers and are driven by the strategic intent of the owner-manager (Jarrett, 1998). Independently owner-operated small firms are usually dependent on the managerial competencies of their owner-managers for success, and their networking behaviour is frequently the result of a process of formal or informal social interaction between the owner and others (Donckels & Lambrecht 1997). Key factors influencing network formation among small firms are the owner-manager's propensity to engage in social networking, the strength of ties that are formed in such networks and the social prestige attached to membership of the network. Such things as the age and education of the owner-manager, the size of their firm and the industry within which they operate can influence these primary motivation factors. What network does (its purpose) may be more important than how large it is (BarNir & Smith 2002).

Within the entrepreneurial venture the role of strategic alliances is to assist the firm in its accumulation of necessary resources. Small firms that enter into networks are likely to do so as a result of their owner-manager's perception that they offer access to new markets, build existing capabilities or assist in defending existing market position. Strategic networks assist the small firm to develop new products and markets through close associations with leading customers or key suppliers. These networks provide access to new technologies and enhance quality and reputation. Networks, particularly within the resource layer help to build existing business capability by accessing financial resources, knowledge and skills, or sourcing physical capital or information. Finally, the network may serve to help the firm defend its market position though joint promotion, the establishment of barriers to new market entrants or protection against substitutes (Jarrett, 1998).

Alliances within networks for small firms can be both formal and informal and can take place across both the production and resource network layers. Given the importance of the owner manager/ entrepreneur in the decision to form an alliance, it is within the social network layer that attention needs to be given in seeking to understand the networking of small firms. A personal network – whether formal or informal in nature – is a valuable source of knowledge and ideas for the owner-manager and can assist them in making strategic decisions (Hogberg & Edvinsson 1998).

THE PRODUCT MARKET GROWTH VECTOR

If the small entrepreneurial venture is to grow it must address what Ansoff (1965) has described as the *Growth Vector*, which suggests that corporate growth is a process of product-market expansion. According to this thesis, the successful growth of the firm is contingent on its ability to achieve a competitive advantage by assembling unique assets and resources, and developing *Synergy* by finding a complimentary fit between new and existing product-market activities. Firms can launch into new markets with existing products (e.g. export), or grow established markets by offering new products or services. Where a firm launches a new product into a new market – diversification strategy – a higher level of potential risk is created because the firm is operating outside its known boundaries. Firm's seeking such growth should understand what assets provide them with competitive advantage, and how best to fit new and existing product-market activities together to achieve synergy. Such firms need a good understanding of the needs of the market, product or service technology and market geography in order to gain competitive advantage (Ansoff 1987).

It has been argued that small firms should seek growth via product or market development rather than diversification (Watts, Cope & Hulme 1998). By contrast diversification increases risk levels and may over stretch internal resources. Among the case study firms growth strategies involving the development of either established markets with new products or new markets with established products took place in-conjunction with diversification strategies.

STRATEGIC THINKING NOT JUST STRATEGIC PLANNING

The entrepreneurial venture that has an entrepreneurial owner-manager, an innovation and the capacity to develop strategic networks will still need to be managed strategically to ensure that it can chart a successful course through the various product-market combinations that it may be faced with. A common adage in small business development programs is the need for owner managers to work on not in their firms (Gerber, 1986). This recognizes the importance of finding time away from the usually hectic and demanding workload of daily operations, in which the owner can undertake strategic or business planning. Further, the mere possession of a written business plan is not sufficient to guarantee success. Of greater importance is the quality or sophistication of the strategy development process that produced this document (Berman, Gordon & Sussman, 1997).

In the development of strategy within the entrepreneurial venture it is important to draw a distinction between strategic planning and the process of strategic thinking. The field of strategic management recognizes a separation between strategy formulation and implementation, although both comprise two ends of a common spectrum (Feurer & Chaharbaghi, 1995).

Strategic behaviour is frequently associated with flexible but focused activities conducted over a relatively long time period. By comparison planning is more about implementation within the short run. Strategy has been likened to a ‘double-loop’ process in which the organization maintains contact with the external environment or market and is prepared to adapt and change in the face of feedback, while planning is a ‘single-loop’ process involving implementation and monitoring (Heracleous, 1998).

Strategic thinking within the small firm requires the owner-manager to possess a clear sense of where both they and their business are going, and the capacity to maintain that focus and direction in the face of external challenges and the allure of new opportunities. A common problem facing small firms is the risk of strategic drift. This occurs when an opportunity presents itself and the desire to seize it is too much for the owner-manager to ignore. Although the ability to identify and pursue opportunities is fundamental to the success of small entrepreneurial firms, the danger is that they overstretch their limited resources and risk failure. Owner-managers must therefore make painful choices about what opportunities to pursue and what to leave alone.

Once the owner-manager is able to clearly identify what their long-term focus and direction is they can begin to develop strategic plans. However, for many the dilemma is to determine what their strategic objectives are.

Unlike their larger counterparts, small firms are strongly influenced by their owner-managers and usually lack the management teams and bureaucratic structures of bigger corporations. Strategic management practice within small firms is usually low and frequently amounts to crisis

management, or at best planning through the budget on an annual basis (Berman, Gordon & Sussman, 1997). The more entrepreneurial a small firm's owner-manager is appears to determine the level of strategic management behaviour, although most small business owners will resort to crisis management when faced with periods of environmental uncertainty (Matthews & Scott, 1995). Strategic management behaviour within small firms seems to be influenced by both the characteristics of the owner-manager (e.g. prior managerial experience, education levels), and the context in which this individual is found (e.g. period of growth, industry type) (Olson & Bokor, 1995). The effectiveness of such formal strategic management behavior appears to be dependent on the level of analysis employed (Ackelsberg & Arlow, 1985). In-depth analysis and **longer-term forecasting have been found to be associated with higher performing managers** (Orphen, 1985). Also of importance is likely to be the owner-manager's level of strategic awareness and capacity to establish clear strategic directions (Rice, 1983).

THE STRATEGIC TRIANGLE

The process of strategic management within the entrepreneurial venture can be likened to that of a triangle comprising three key elements: i) strategy, ii) structure and iii) the resources required to achieve the strategic goals. This strategic triangle recognizes the strategic theories that suggest the need to maintain a harmonious relationship between strategic direction and the organization's structure (Chandler, 1962). However, it also recognizes the importance of building future strategy around the firm's resources and not out-stripping those resources (Barney, 1991). Strategy requires the considered positioning of the firm and its products within targeted markets seeking to use innovation to create a competitive advantage through differentiation (Porter, 1980).

However, the firm must have adequate core competencies (Prahalad & Hamel, 1990), which can be both tangible and intangible but offer superior outcomes over what might be available to competitors (Reed & DeFillippi, 1990). For resources to be a source of competitive advantage they should be of commercial value, not available to competitors, not easily substituted by customers and difficult for competitors to easily copy (Barney, 1986).

CONCLUSION

Throughout its development cycle the strategic management of the entrepreneurial venture will require consideration of these three elements. For small firms this strategic triangle is likely to be particularly important as it is likely that resource constraints will significantly impede the firm's capacity to fulfill its' intended strategy. However, while very small firms generally lack any specific organizational structure, as they grow in scale and scope, it will be important for them to develop appropriate structures that enhance their strategy and make best use of their relatively limited resources. Successful growth will typically involve the continuous juggling of these three strategic elements and the need to keep the strategic triangle in equilibrium.

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