Management

Strategic Management

Strategic issues in Small Business

Paper: 3, Strategic Management

Module: 35, Strategic Issues in Small Business

Principal Investigator
Prof. S P Bansal
Vice Chancellor
Maharaja Agrasen University, Baddi

Co-Principal Investigator
Prof Yoginder Verma
Pro–Vice Chancellor
Central University of Himachal Pradesh, Kangra, H.P.

Paper Coordinator
Dr. Anil Gupta
Senior Assistant Professor
University of Jammu, Jammu 180006.

Content Writer
Dr. Sudhanshu Joshi
Head, School of Management, Doon University,
Dehradun PIN 248001, Uttarakhand, INDIA
Learning Objectives:
The Learning objectives of the module are to explore relationship between corporate culture and Strategies, to address the following questions:

1. What is the scope of Strategic planning for small businesses
2. To know the impact of Strategic planning on competitiveness of Small Businesses

1. Introduction
The importance of SMEs to world economies is well recognized. SMEs (make up the largest business sector in every world economy, and governments around the globe are increasingly promoting and supporting SME growth as part of their overall national development strategy.
While they dominate in terms of absolute numbers, SMEs are also important because they are key drivers of employment and economic growth.

SMEs account for a significant proportion of economic activities in India’s urban and rural areas; generating over 70% of all new jobs annually (ASSCOM, 2012). The role of SMEs is not only limited to economic growth of the nation, besides it is also in terms of employment creation, income generation, economic diversification etc. The SMEs form one of the fastest growing and most dynamic sectors in Indian economy. They are estimated to be growing at an annual rate of 10% even in the lean years; the export sub sector contributes to the growth index substantially.

A small business has a choice of two goals: Increase profits but stay small, or grow into a larger business.

2. Potential of SMEs

Among developing countries, SMEs has addressed subsential growth. Their growth can be determined by-
1) Their ability to integrate with the global economy through trade and investment;
2) Their capacity to maintain sustainable government finances and sound money; and
3) Their ability to put in place an institutional environment in which contracts can be enforced and property rights can be established.

As globalization proceeds, transition and developing countries and their enterprises face major challenges for strengthening their human and institutional capacities to take advantage of trade and investment opportunities. While governments make policies in trade and investment areas, it is enterprises that trade and invest. Therefore, supply-side bottlenecks in the trade and investment areas and how governments, development partners and the private sector itself address these constraints have direct implications on the economic growth potential of transition and developing countries. SMEs play a key role in transition and developing countries. These firms typically account for more than 90% of all firms outside the
agricultural sector, constitute a major source of employment and generate significant domestic and export earnings. As such, SME development emerges as a key instrument in poverty reduction efforts. Globalization and trade liberalization have ushered in new opportunities as well as challenges for SMEs. Presently, only a small part of the SME sector is able to identify and exploit these opportunities and deal with the challenges. The majority of SMEs in developing and transition countries, however, has been less able or unable to exploit the benefits of globalization and, to add to the situation, are frequently under pressure on the local or domestic markets from cheaper imports and foreign competition. A major objective of work to promote the development of the SME sector is therefore to change the balance between these two groups of SMEs and to equip SMEs to better meet the challenges of globalization and to benefit from its opportunities. SMEs, due to their size, are particularly constrained by non-competitive real exchange rates, limited access to finance, cumbersome bureaucratic procedures in setting up, operating and growing a business, poor state of infrastructure and lack of effective institutional structures. The removal of these constraints is a daunting task calling for holistic SME support, i.e. an enabling environment for SME development consisting of functioning macro, macro and micro level institutions.

3. Performance and its effectiveness in Small Firms

Across world, Small business struggled with business constraints specially Finance, Market and Human Resource Management. Table 1 exhibit the types of constraints and their effects.

**Table 1: Constraints to Business Growth in SMEs**

<table>
<thead>
<tr>
<th><strong>Finance</strong></th>
<th><strong>Market</strong></th>
<th><strong>Human Resources Problems</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Growth, especially external growth, requires additional capital investment which is sometimes difficult for a small firm to arrange</td>
<td>Growth can be achieved to the extent that the size of the market permits. If a business grow faster than the increase in the size of the market, it is likely to face failure.</td>
<td>As a firm grows, management can become detached and loose the personal touch with employees and customers. Without proper systems and processes motivation and morale can suffer resulting in inefficiency.</td>
</tr>
</tbody>
</table>

Small businesses performance encompasses three specific areas:

(a) Financial performance (profits, return on assets, return on investment, etc.);

(b) Product market performance (sales, market share, etc.); and
(c) Shareholder return (total shareholder return, economic value added, etc.).
And subsequently, business outcomes includes: Qualified labor; Commitment of employees; Job satisfaction of employees; New product/service development capability; Product/service quality; Customer satisfaction; Sales growth; Market share growth; Return on sales; Return on assets; Overall profitability. Whole organization system is composed of five overlapping subsystems: strategic, technological, human-cultural, structural, and managerial. Each of these subsystems functions interdependently and with the external environment in which the Organization operates; these subsystems work as a collective informing the actions and behaviors of the whole organization. Figure 1 illustrate small business performance variables and potential outcomes.

**Figure 1: Performance and its effectiveness in Small firms** *(Source: Author)*

4. Why Small Business needs Strategy
Strategic management is largely regarded as the rational process by which senior management identifies courses of action and responses to complex and dynamic environmental forces. It is traditionally concerned with hegemony, size, utilization of
resources, achieving dominant positions and internalizing issues of control and fit. The scale, scope and complexity of the strategic management field are problematic in that there is no overarching, generic core body of knowledge. There are instead contextual understandings of what is ‘strategic’ and a range of competing and exclusive schools of taught. This difficulty of definition prevents any conclusive diagnosis of the effectiveness of the strategic management as an aid to organizational effectiveness, yet the methodological and theoretical difficulties with the field enable invention and reinvention of contextual understanding of what is ‘strategic’.

For SME sector, Strategic planning is highly required to reinvention/ reengineering the strategy process to suit the context. A good planning helps small business to cater business risks and challenges. Figure 1 illustrates victorious Strategic flow for a small business i.e. how vision act as broad “what to do” situation; setting up Key Success Indicators ensured the “deliverables”; SWOT analysis help firm to understand the industrial positioning and afterwards the strategic Development ensured to meet vision statement of the firm.

Figure 2 : various aspect of strategic importance for small businesses (Source: Author)

5. Strategic Planning in Small Businesses

Like in medium and large scale companies, small firms also need to determine their strategies, its strategic management should blend with: (a) Core values of the firm and
requisite support in terms of its corporate structure; (b) Survival strategies to reduce management inadequacies.

The major concern of small business firms includes:

- **Growth of Sales** - Larger the sales, larger shall be the growth of the firm. Small firms need to visualize the process and patterns so that their profit can be maximized using existing set of business activities

- **Cost-benefit analysis** - For long term investment and financial decisions, small firms has to undergo various cost-benefit analyses across value chains.

- **Healthy Balance sheet and cash inflows** - Gearing operations to the income statement, while ignoring the balance sheet, are all too common. Lack of concern with cash flow and the productivity of capital employed can be fatal. Managers tend to seek new funds instead of making better use of those they already have.

Figure 3 exhibit the strategic planning for small firm that blend vision with the resource mobilization considering Business processes, customer segmentation, products, supply chain and credit management into account.
Strategic planning in small business can be in to four thrust areas:
1. To empirically confirm the presence or absence of strategic planning in small firms
2. To provide empirical evidence of the value of strategic planning
3. To examine directly or indirectly the appropriateness of specific features of the planning process

Figure 4: Strategic Mapping and Profitability relationship among Small firms

Figure 14 illustrate the relationship between strategic mapping and Profitability. Although a causal link between planning and success has not been established, these sources favor strategic planning as a tool to build success for small business. Additionally there is little consensus on what constitutes effective planning for small business.

6. Scope of Strategic Management in Small Business

Various strategic models and framework support small business based planning and implementations. The major strategic models are listed in table 2

Table 2: Strategic Models for small Businesses

<table>
<thead>
<tr>
<th>Henderson (1991)</th>
<th>Strategic plan builds on an organization’s unique purpose</th>
</tr>
</thead>
<tbody>
<tr>
<td>Van der Heijden(1996)</td>
<td>Offers a useful model for examining the various schools of</td>
</tr>
</tbody>
</table>
strategic planning. He cites three general planning paradigms:


7. Key elements of SMEs Strategies

The key elements of the SME strategies are mentioned in table 3

Table 3 : Key elements of SMEs Strategies

<table>
<thead>
<tr>
<th>THE TEN ELEMENTS</th>
<th>Strategy and Planning</th>
<th>Execution and alignment</th>
<th>Performance and reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Take a broad view of sustainability.</td>
<td>Understand the key sustainability drivers, risks and opportunities for your organization. As important as they are, remember to look beyond environmental issues. Finding innovative ways in which your company can be a good corporate citizen to the benefit of employees, customers and suppliers will yield benefits to your business.</td>
<td>National, international and industry wide initiatives exist that help businesses become more sustainable. Engage with these organizations, tap into their knowledge and experience. This way, implementing a sustainability strategy will be quicker and easier.</td>
<td>Becoming more sustainable often means being more efficient. Resource efficiency, for instance, benefits the environment and reduces the cost of running a business. Make the link between consuming less water and electricity, or producing less waste, and improving profits clear within your business.</td>
</tr>
<tr>
<td>2. Define in detail what sustainability means to your company</td>
<td>With a clear definition to which everyone in the company can refer and clear success measures, any efforts to invest in sustainability or change business practices will focus on the right goals.</td>
<td>The delivery of any strategy is more successful if an organization knows who is in charge of it. Have senior management drive the policy, appoint sustainability champions and communicate the importance of sustainability to every level of the company.</td>
<td>Tracking progress towards the goals of a sustainability strategy is vital in justifying it to management, and in fully understanding the commercial benefit it brings. Develop clear metrics, review them regularly and whether progress is fast or slow, keep setting realistic, attainable targets.</td>
</tr>
<tr>
<td>3. Engage all stakeholders.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Remember that you are not alone.</td>
<td>5. Establish responsibility and communicate widely.</td>
<td>6. Take it step by step.</td>
<td>10. Invest in the future.</td>
</tr>
<tr>
<td>8. Tie sustainability to profit.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
8. Growth Strategies for Small Businesses

- Selecting in-house competencies, invest to create competitive advantages, differentiate and innovate in the product or service line (Organic Growth);
- Leverage upon the market, products and revenues of other companies (In-organic Growth);
- Business expansion with the help of core competencies and sales refers to Organic Growth and is in contrast with In-organic growth approach where expansion objectives are met through Mergers and Acquisitions (M&A).

8.1 Organic Growth Strategy

Companies growing organically not only measure their success on financial metrics alone but take note of other metrics like:

- Customer Satisfaction Metrics
- Product Quality Metrics
- Logistics & Supply Chain Metrics etc.

8.2 Inorganic Growth Strategy

Increasing output and business reach by acquiring new businesses by way of mergers or acquisitions.

Provides the following benefits:

- Helps reduce competition in the market place;

(Source: MacGregor, 1999).
• Instantly adds new brands and product/service lines;
• Provides access to fresh customer base and adds new geographical locations and in many
  cases, an established marketing channel;
• Economies of scale are achieved over a period of time;
• A fresh breath of management skills (fresh blood) ;
• Time-to-market is substantially reduced which gives businesses a significant competitive
  edge

8.3 Why inorganic Growth Strategy
• Industry and economic factors play a crucial role
• Slowing industry growth rate, fragmented industry and too many competitors fighting for the
  same market share
• An economic slump creates opportunities for cash rich companies to get hold of unutilised
  capacities of loss making competitors at attractive valuations.

8.4 Growth Strategies
The following are strategies for external growth-
• Merger;
• Acquisition;
• Takeover;
• Differences between strategies often emerge in aftermath of process

8.4.1 Merger-
• Two businesses of similar value are combined under common ownership;
• Generally categorized as upstream, downstream or lateral;
• Upstream merger – smaller company seeks out larger company and is acquired by it;
• Downstream merger – larger company seeks out and acquires smaller company; and
• Lateral mergers are the combination of equals
• Normal for senior management positions in new, merged entity to be shared roughly equally between the managements of the two constituent firms, taking account of skills.
• Negotiations involve the relative ownership interest each company will hold in the merged entity.

8.4.2 Mergers and Acquisitions (M&A)
• Negotiations focus on the relative value of each company in negotiating a purchase price.
• Implication is that while merged companies operate on a cooperative basis, an acquisition involves absorbing part or all of another company.
• Especially true concerning acquisitions of companies in the same industry.

9. Need of Industrial Support
Currently there is an immediate need to assist in development of small and medium enterprises is a stronger institutional support, drafting a national strategy for SMEs, supplementing of legislation, financial support, business advices etc. The following measures are required to maintain the sustainable growth of small firms, including:
• Creating and building strategies and development programs.
• Building a suitable environment for entrepreneurship and economic activities
• Promotion of the appropriate locations for foreign investors and entrepreneurs.
• Support to SMEs.
• Promotion of local products and services.
• Ensuring access to capital.
• Development of various training forms for business.
• Cooperation among research institutions, businesses, and government.