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# Solutions for Creating Sustainable Competitive Advantage in Small Businesses

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## ABSTRACT

In the globalization stage, all bussinesses exist for some purpose or goal, and managers have the responsibility for combining and using organizational resources to ensure that the organizations achieve their purpose.

Strategic Management is a complex concept which has to do with an organization's scope and direction of activities, matching the activities with the environment and resource capability, as well as the values, expectations and goals of those influencing strategy.

This research focused on small businesses, their features and dynamics in the course of making use of the tools and techniques in strategic management. It investigates how small businesses, in their course of building competitive advantage, make strategic decisions, and the factors related to the mere smallness of such businesses as affecting strategic choice are discussed.

***KEYWORDS:*** *small business, competitive advantage, sustainable development*

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## 1. INTRODUCTION

Small and large firms possess fundamentally different resources and capabilities and these differences will and should affect their choice of strategy. Small businesses are different in their management style, decision making behavior and others, from their larger counterparts and are confronted with various challenges and blessed with a number of opportunities in their struggle to achieving a fit between their capabilities and their environmental context.

Understanding the features of small business and their management and decision making behavior is very important in the course of studying their strategic choice and mode of doing business. The number of publications on Strategic Management are many, and essentially most of them deal with large, established business corporations and until lately, has virtually ignored small-business firms. Small businesses however, are becoming increasingly important almost in every sector, and they cannot be ignored when discussing strategic management.

In discussing strategy, the factors on which organizations differ are very important, as strategy is basically managing these factors in dealing with competitors who may or may not share the factors. Of the many factors on which organizations can differ, size is probably the most apparent one. The mere size of an organization can be a significant motive by itself to adopt or not to adopt a particular strategy. In applying the concepts and techniques of strategic management, the smallness of a business by itself can trigger many special considerations. As strategic management is concerned with utilizing internal capabilities to deal with environmental variables, small businesses can be in a different situation in this regard. What they can do not only to survive but also to grow and remain competitive is an important issue.

The paper presented what small businesses need to do in their course of strategic choice and what internal and external factors shape their strategic management process. In addition, the research indicated what the relative strengths and weaknesses of small firms are and to discuss how small firms can build on their strengths and neutralize their weaknesses in their course of strategic choices in different industry contexts

## 2. Literature review

### Small business

The term Small Business is defined in different contexts differently. Many authors give a quantitative definition in terms of number of employees, capital, turnover etc.

Many governments also have similar 'statistical' definition of Small Business for administrative purposes. "Some use number of employees, some turnover, some capital employed 'variously defined', and some a combination of all three. Risking a broad generalization, one may say, however, that in Europe small firms are those with less than 200 employees and medium-sized firms are those with 200-500 employees. In the US, all firms employing up to 500 employees are regarded as small."

Thus there is lack of consensus as what a small business is. This lack of consensus is due mainly to the environment where the term is applied. When talking in statistical terms, I think it is apparent that the whole environment is taken into account and the size is measured in relation to the totality of actors in the given economy. In the small economies of many developing countries, it is very rare to find a firm employing 500 people. If there is one or few, then they should be 'giants' in that context and we cannot regard them as small simply adopting the statistical definition of the US where to have firms with tens of thousands of employees is not uncommon.

Businesses are also categorized under Small-and-Medium-Sized (SMEs) in which also the size varies from country to country. Many authors also classify businesses under micro, small, and medium enterprises

The other way of looking at the concept of Small Business is to take qualitative factors and to describe it in relative terms. Even listing the qualitative specifications is not easy and differs from county to country. Mengisteab gives a list (but not exhaustive) of the general qualitative specifications in defining SMEs. The use of general qualitative specification that can be used in different circumstances would give a better understanding of the concept. For this reason, I would take the following definition of Small Business as presented in the book by Hunger and Wheelen quoting the United States Small Business Administration. Hence, *"A Small Business is one which is independently owned and operated, and which is not dominant in its field of operation."*

From such arguments it is clear that the definition for small business is not easy and is dependent on various contexts. It should be clear that in making any specific study on small business in a given context, one should take a working definition appropriate for that particular context (industry and country) as developed by relevant references (trade and business government authorities, or similar bodies).

*Management Process and Decision Behavior in Small Firms*

The management process in small firms is not the same as that of large ones. It bears little or no resemblance to management processes found in larger organizations. In managing their resources towards creating competitive advantage, small firms make use of their unique features (see above) available to them because of their size, and which are not available in the larger counterparts. Jennings and Beaver (1997) described the management processes in small firms to be *adaptive* as opposed to the practice in their larger counterparts, which they described as *predictive*.

In the larger organizations competitive advantage is often created deliberately as a result of the pursuit of explicit policies designed to minimize operating costs and/or achieve product/service differentiation. Consequently strategic management becomes primarily a *predictive* process concerned with the clarification and communication of long-term objectives and the feedback of information to indicate successful or unsuccessful achievement of pre-determined goals.

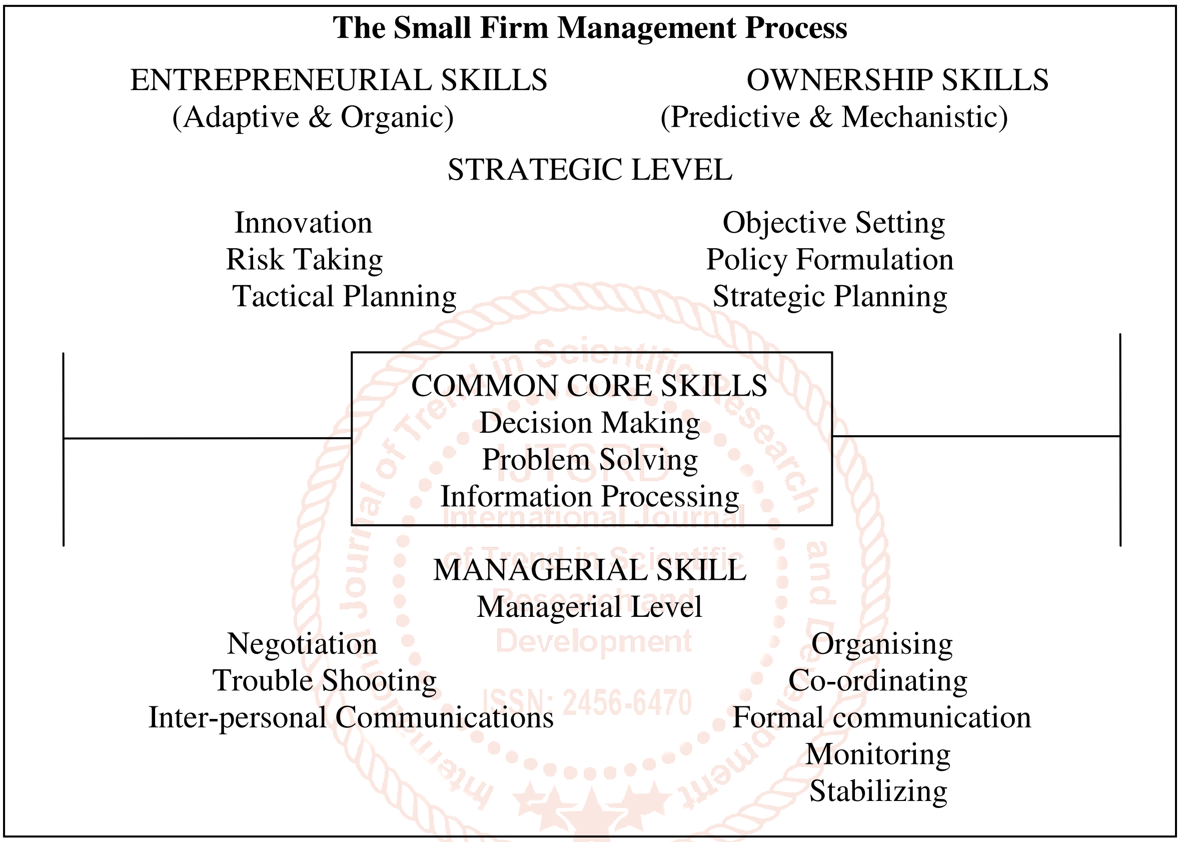
In contrast, competitive advantage in the smaller firm often arises accidentally as a result of the particular operating circumstances surrounding the enterprise. Here, strategic management becomes primarily an *adaptive* process concerned with manipulating a limited amount of resources, usually in order to gain the maximum, immediate and short-term advantage. In the small firm efforts are concentrated not on predicting and controlling the operating environment but on adapting as quickly as possible to the changing demand of that environment and devising suitable tactics for mitigating the consequences of any threatening changes which occur.

In the small firms, the management process is characterized by the highly personalized preferences, prejudices and attitudes of the firm's entrepreneur, owner, and/or owner-manager. Mintzberg described such organization as having little or no staff, with a loose division of labor and a small managerial hierarchy. Little of its activity is formalized, and it makes minimal use of planning procedures or training routines.

The management process in small firms is also characterized by the nature of power balance and decision making behavior of the manger(s). According to Mintzberg, in small firms, which he refers them to have a *simple* structure, power tends to focus on the chief executive, who exercises a high personal profile. Formal controls are perceived as a threat to the chief's flexibility and that the manager drives the organization by sheer force of personality or by more direct interventions[2]. Decision-making is likewise flexible, with a highly centralized power system allowing for rapid response. Thus the small firm management process cannot be separated from the personality set and experience of the key role player or players.

Organization structures in small firms, in so far as they exist, are likely to develop around the interests and abilities of the key role players. Such organization structures are likely to be organic and loosely structured rather than mechanistic and highly formalized.

The following figure shows the management process in small firms as described by Jennings and Beaver (1997).




Source: Peter Jennings and Graham Beaver (1997)

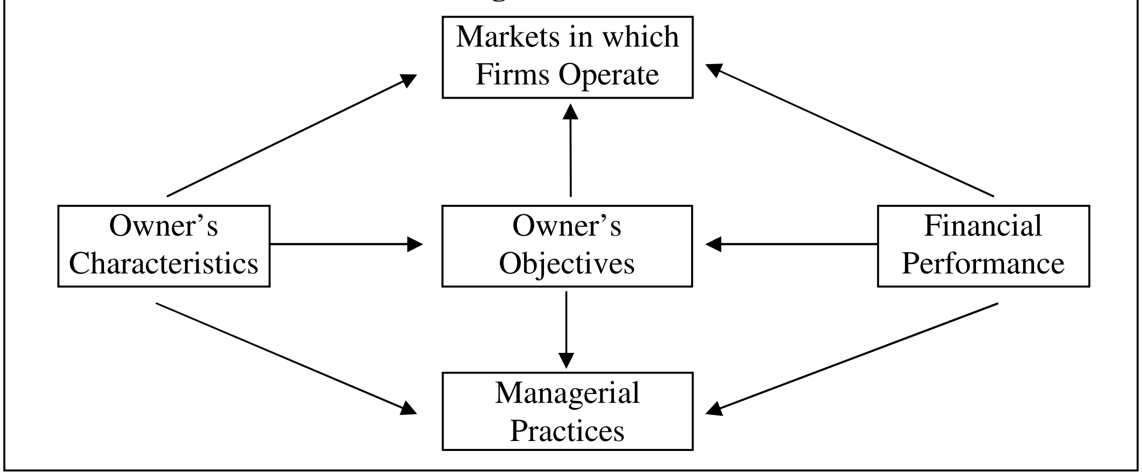
### 3. Evaluate the relative strengths and weaknesses of small businesses

The relative strengths of large firms lie mostly in resources, while those of small firms are generally argued in terms of behavioral characteristics. Small and large firms are likely to play complementary roles in different aspects, in the sense that they are better at different aspects of a business.

The strengths and weaknesses of small firms can differ from industry to industry. Because of their structure and management style, small firms, in many contexts, posses resources and capabilities that differ from those of large firms, and that these differences make small organizations particularly well suited to certain industry contexts but not others. Small businesses, perhaps because of their speed, flexibility, and niche filling capabilities will be attracted to and successfully enter industry environments in which these resources provide the greatest advantage. Large firms may likewise seek environments in which their unique resources will provide advantage.

David Gadene (1998) quoted a conceptual model by Cragg and King, which involves casual relationships between various factors and small firm financial performance. The model shows that the main factors *directly* affecting financial performance of small businesses are markets in which the firm operates and managerial practices. These are in turn affected by owner's characteristics and owner's objectives.

[2] Ibid., P 615




**Factors Influencing Small Business Performance**

Source: David Gadenne (1998)

The relative strengths and weaknesses of small (and large) firms being dependent on different contexts, the following table gives a summarized out look to this end.

**Relative Advantages of Small and Large Firms**

| Small Firms | Large Firms |
|---|---|
| Little bureaucracy | Formal management skills |
| Rapid decision making | Able to control complex organization |
| | Can spread risk over a portfolio of products |
| Risk taking | Functional expertise in staff functionaries |
| Motivated and committed management | More specialized labor |
| Motivated Labor | Time & resources to establish comprehensive |
| Rapid and effective internal | external Science and Technology networks |
| Communicational, shorter decision chains | Comprehensive distribution and servicing facilities |
| Fast reaction to changing market | High market power with existing products |
| Requirements | Economies of scale and scope in R&D |
| Can dominate narrow market niches | Can support the establishment of a |
| R&D efficiency | large R&D laboratory |
| | Access to external capital |
| Capacity to customization | Better able to fund diversification, synergy |
| Capable of fast learning and adapting | Able to obtain learning curve economies |
| Routines and strategy | through investment in production |
| | Capacity for absorption of new |
| Appropriation of rewards from innovation | knowledge/technology |
| Through tacitness of knowledge | Able to erect any barriers |

Source: Robert W. Vossen (1998)

## 4. Strategic choice and management: A small busines perspective

How firms choose their strategies and what strategies are more appropriate to which firms is a basic question. Small businesses, because of their unique features outlined earlier, need to critically see this question in their efforts to successfully compete in their given environments. Existing research on strategic choice and management mainly deals with large businesses and study of strategic management in small businesses is relatively new. Baird, et al. quote several authors in their work of strategic choices of small firms and conclude that "strategic choices of small firms and the factors that influence these choices are being identified"

As a general rule, a focused (also called niching) strategy is often advocated as the best suited strategy to smaller firms. This is mainly because it is these which have the flexibility to respond quickly to the specialized needs of small segments. Of the three strategies proposed by Porter (1985), it appears that only the "focus" strategy - concentrating on particular market segment(s), is applicable to small businesses given their limited resources.

According to Lee Khai et al (1999), for successful niching, SMEs should supply products that are substitutable to that of their bigger rivals' instead of totally differentiated ones.

Extending the work of Cooper et al (1986) described by providing a formal game-theoretic explanation as to what reactions could the small businesses which practice the niching strategy expect from the bigger rivals.

Lee Khai et al. (1999) rejected what is seen as 'conventional' argument, on why the bigger firms choose to ignore the niches supplied by the SMEs, which usually rely on some form of irrationality on the bigger firms. In their alternative explanations, Lee Khai et al., put that the bigger firms make a rational decision to deliberately ignore the niches filled by the SMEs and to accommodate the entry of the SMEs into their markets. According to the authors, such a decision is taken because, just as the SMEs do not wish to engage in direct competition with the bigger firms, the latter are similarly motivated. "Direct competition with the SMEs depresses prices not only in the market niches, but also in all other market segments which are currently supplied with substitutable products by the bigger firms. The loss in margins, and hence profits, to the bigger firms in these other segments can be sufficiently large such that they prefer to adopt a 'live and let live' attitude towards the SMEs which choose to supply the market niches[3].

When the bigger rivals choose to fight, and not to ignore, the SMEs' entry into their markets despite the high cost of such actions, (the bigger firms are willing to take such costly actions if they perceive that, by using their vast financial resources, there is a good chance that they would succeed in driving out the SMEs from their markets), Lee Khai et al propose that SMEs should signal that they are committed to stay in the market, and that any aggressive competitive actions taken by the bigger rivals will only result in protracted competition to the detriment of all parties. In order for the signal to be credible, the authors suggest that SMEs form strategic alliances to overcome their disadvantages against their bigger rivals. The increase in resources and/or gain in competitive advantages, accruing from the strategic alliance serves to signal to the bigger rivals the SMEs' ability to defend their turf and their commitment to the market. This therefore deters the bigger rivals from contemplating aggressive campaigns in the first place, and even forces them to accommodate the presence of the SMEs in their markets instead, the authors concluded.

Baird et al. also explain that the strategic options available to the small business can be followed by acting independently (competitive strategies) or by acting cooperatively with other firms (cooperative strategies). According to the authors, though cooperative strategies are not frequently adopted by small firms, such arrangements are a good mode of commercializing products in foreign markets and overcoming resource scarcity.

A low cost leadership position is also possible for small businesses. This comes from two major factors: (1) cost consciousness, where cost is always a prominent consideration in decisions for items like travel, equipment and supplies; and (2) adaptability to market conditions, where key cost components -- like inventory -- can be adjusted rapidly depending upon demand or supply for a business' products or services.

## 5. Conclusion

The main feature of strategic management in small businesses, which can be regarded as unique, is the way it is developed and managed (implemented). This in turn has to do with the ownership structure and management process in small businesses. Strategic management in small businesses is enacted in a highly personalized manner and is strongly influenced by the personality, disposition, experience and ability of the entrepreneur/ owner-manager.

The analysis of strategic management in small businesses as a topic is too general to lead to concrete and specific results, and can be discussed only at theoretical level. As the concept, definition and nature of small businesses differ from environment to environment and from industry to industry, so will the study and analysis about them. In practice, in addition the need to be specific to a firm's business environment, one needs to carefully look at the specific nature of the industry, in which the small business operates in order to come up with relevant arguments as to how such firms [should] behave in their course of strategic management. Each industry has its own unique features to affect the choice and management of small business strategy.

The study of strategic management in small businesses is the search for the dynamics of interactions between various factors influencing the practice, including the firms' owner's or entrepreneur's objectives and characteristics, managerial practices, nature of industry, markets and their competitive structure, and so on. Lack of adequate resources to push further with an already established strategy is an impediment for small businesses, and this may force them to abandon the route when confronted with a threat, mainly a bigger rival, and look for alternatives, unless they have some

[3] Lee Khai S. et al. Dealing with Resource Disadvantage: Generic Strategies for SMEs *Small Business Economics*, June 99, Vol. 12 Issue 4. P.300.

means to confront or challenge the rival. On the other hand, the ownership structure and decision making behavior in small businesses allow them to act swiftly and to seize emerging opportunities, and thus to be much better efficient and effective.

As has been indicated earlier the question of which strategic options result in optimal small firm performance has been addressed but not resolved. Moreover, much of the research on the strategic management of small firms has dealt with the formality of strategic planning rather than the content of the strategies or reasons for their adoption. However, strategic choices of small firms and the factors that influence these choices are being identified. The strategic options available to the small business are not limited, and can vary from industry to industry and from context to context. The generic strategies, Cost leadership, Differentiation, and Focus are applicable to small businesses. Unlike in the larger businesses, in selecting any strategy, small businesses need to pay special attention to the possible reaction especially from the larger rivals, and the way of handling such reactions, as this is the way to *sustain* any competitive advantage gained for a fairly long time.

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