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The Strategic Management of Small Firms: Does the Theory Fit the Practice?

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THE STRATEGIC MANAGEMENT OF SMALL FIRMS: DOES THE THEORY FIT THE PRACTICE?

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ABSTRACT

While the range and depth of strategic management literature is substantial, it has generally been developed from the perspective of the large corporation. This paper examines the strategic management literature and considers its application in the context of small business management. Drawing on case studies of owner-managers engaged in the development of fast growing small firms, the paper examines which theories are of relevance and which are not. While many of the strategic management theories do have application to small firms, caution is advised in seeking to impose large company experience and practice on small firms.

Key words: strategic management, small firms, owner-managers.

STRATEGIC MANAGEMENT AND SMALL FIRMS

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 (Ennis 1998). This intuitive pragmatic nature of strategy development in small firms is characterised by the absence of formal planning within this type of company (Unni 1984). It has been argued that entrepreneurs do not plan because they lack the knowledge, confidence or skills to do so (Posner 1985).

While the lack of formal planning within small firms is recognised, the importance of strategic awareness and personal commitment from the entrepreneur is viewed as having the potential to serve as a counterweight (Gibb and 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 assist in achieving goals (Sandberg, Robinson and Pearce 2001). Research into the relationship between formal strategic planning and financial performance has been unable to offer conclusive support to the benefits of such activity (Robinson and Pearce 1984; Pearce, Freeman and Robinson 1987), although it has suggested that strategic planning is appropriate for both large and small firms (Schwenk and 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 and 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 and 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 and 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 and 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 and Pearson 1986), however, evidence suggests that formal strategic management behaviour is advantageous to small firms experiencing growth (Robinson 1983).

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 and 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 and 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 and Bokor 1995). The effectiveness of such formal strategic management behaviour appears to be dependent on the level of analysis employed (Ackelsberg and Arlow 1985). In-depth analysis and longer-term forecasting have been found 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).

APPLYING STRATEGIC THEORY TO THE SMALL FIRM

There are many theories relating to strategic management practice, at least nine distinct 'schools' of thought have been identified (Mintzberg, Ahlstrand and Lampel 1998). While most of these theories have been develop from the experience of large firms it is possible to relate them to the small firm to evaluate how useful they are likely to be to owner-managers. Research being undertaken by the author into the strategic orientation of small business owners has gathered case studies of owner-managers who have experience significant growth in their firms over time. Four cases were selected for the study, all manufacturers. Each of these firms experienced significant growth over the previous six years and required their owner-managers to undertake strategic decisions and engage in various forms of business planning and strategic management behaviour. All were observed over a period of three years while the owner-managers engaged with a university-based management development program. Table 1 provides a brief description of each firm.

TABLE 1: THE CASE STUDY FIRMS

Case Study Firm:	Manufacturer #1	Manufacturer #2	Manufacturer #3	Manufacturer #4
Industry:	Printing	Air-conditioning	Pet Food	Processed Vegetables
Size:	56 employees	120 employees	35 employees	80 employees
Exporting:	Yes	Yes	Yes	Yes
Family Business:	No	No	Yes	Yes

Case study method employs 'replication logic' rather than a 'sampling logic' and as such each case needs to be viewed as an independent study with the researcher seeking to identify patterns across the cases that reveal new theory or support existing theory (Yin 1989). The method allows similarities and differences to be examined across a group of cases with subtle discrimination between these groups possible (Chetty 1996).

STRATEGY = STRUCTURE

Among the earliest perspectives of strategic management was its function as a process of determining the firm's long-term objectives and goals while deciding how to allocate resources and take actions to achieve these goals (Selznick 1957). This "design school" (Mintzberg, Ahlstrand and Lampel 1998) suggests that organisational structure should be aligned with strategy leading to the equation: 'strategy = structure' (Chandler 1962). In this view the CEO of the firm plays the role of the '*architect of organizational purpose*' who must become sufficiently detached from daily work roles to develop long-term aims and ensure that the firm remained on track and not subject to 'strategic drift' (Andrews 1999).

For small firms experiencing rapid growth the ability keep structure in balance with strategic direction is difficult. During their periods of expansion each of the case study firms experienced significant growth in both employee numbers and organization. For example, Manufacturer #1 was established as a pre-press business. It grew by acquiring an established printing firm, adding warehousing, graphic design, and web site development and sales divisions. Recent expansion has also been via acquisition and merger. Manufacturer #4 also expanded through acquisition of rival firms until it controlled around 80 per cent of its domestic market. Manufacturers #2 and #3 experienced organic growth but #2 had to establish several offices across Australia and South Africa.

In each case the role of the owner-manager was crucial to the firm's development. All firms were owned and operated by multiple directors however; there was in each case a dominant director who provided a leadership role serving as the *"architect"*. However, a major challenge for small firms engaged in expansion strategies is the ability to forecast long-term aims due to the highly dynamic nature of their growth path and the entrepreneurial nature of the firm's management.

PRODUCT-MARKET GROWTH

The ability of firms to plan strategic growth options has been addressed by a 'planning school' of strategic management theories (Mintzberg and Lampel 1999). An important theoretical framework is the idea that growth is a process of product or market expansion (Ansoff 1965). 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' (Ansoff 1965). 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 and 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. Manufacturer #2 expanded markets first and then sought to expand these markets with new product offerings. Manufacturer #4 developed the domestic market with a range of products and then launched an export strategy to Singapore with these established product lines.

As noted, Manufacturer #1 grew through acquisition involving diversification into new product-market combinations. Manufacturer #3 launched a diversification strategy involving export of a new product to Japan. In both these cases the level of risk associated with such diversification was high and Manufacturer #3 was forced to withdraw from this export market after several years in order to stabilise the firm's cash flow and profitability. Manufacturer #1 maintained a focus on the printing industry for all its acquisitions and thereby enhanced the level of synergy between all its new divisions. All four cases found it preferable to follow the lower risk strategy of product or market development, although the temptation to chase a diversification opportunity was frequently being considered.

COMPETITIVE POSITIONING

The 'positioning school' of corporate strategy seeks to find the most appropriate placement for the firm's products or services into targeted markets (Mintzberg 1998). Achieving competitive advantage is a process of knowing which products should be retained as cash cows, which should be supported for future growth and which should be withdrawn so as to allocate scarce resources to the rest (Hatten and Schendel 1977; Henderson 1984).

Firms seeking to achieve a competitive position in a market must find either a way to reduce operating costs and become the lowest cost producer, or add value to product or service offerings so as to differentiate against the competition (Porter 1980). Environmental scanning and adaptation to the needs of the market are therefore important aspects of the successful position of firms for competitive advantage (Porter 1991).

Each of the case study firms followed different positioning strategies. Manufacturers #1 and #2 placed high importance on value adding and differentiation from an early stage. Innovation, in product and process was actively encouraged by the owner-managers to find ways to allow the firm to charge a slight premium against the competition. Both firms successfully charged such prices and focused on profit margin rather than gross turnover. Manufacturers #3 and #4 initially adopted a more price driven approach. Manufacturer #3 commenced exporting to secure higher margins, but soon found that their Japanese buyers wanted to raise quality and reduce price. This squeezing of profitability was the trigger that led them to abandon exporting. They subsequently shifted to value adding and differentiation seeking higher margins in an otherwise price sensitive market.

COMPETING ON RESOURCES

The resource-based theories of strategic management suggest that firms should look inward at their resources and ensure that they match their strategies against their skills, resources and abilities (Grant 1991). Of particular importance is the ability of the firm to identify its 'core competencies' (Prahalad and Hamel 1990), which can be both tangible and intangible but offer superior outcomes over what might be available to competitors (Reed and 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). A core competence should enable the firm to enter new markets or add significant value to the attractiveness of the firm's products (Prahalad and Hamel 1990). Value is generally created where the scarcity of the resource matches the demand for it and the firm's ability to acquire or possess it (Collis and Montgomery 1995).

Among the four case study firms there was recognition that profitability was an outcome of their ability to secure niche positions in the market and compete through differentiation strategies that would permit premium pricing. Manufacturers #1 and #2 sought to secure such differentiation through the application of innovation in product and process. Both firms invested in state of art technology for manufacturing and provided funds for R&D and the education and training of their key staff. Innovation in marketing and distribution strategies was also noticeable. Manufacturers #3 and #4 also invested in state of art manufacturing facilities so as to secure export markets, but found this simply benchmarked them against global competitors.

Within the domestic market Manufacturer #3 had a differentiation in the manufacture of its principal 'cash cow' product that it was seeking to promote through an increased investment in marketing. Manufacturer #4 had secured growth in the domestic market by developing superior quality and reliability in comparison to local competitors. However, the ability of such competencies to offer similar advantages in export markets was unknown at time of writing.

STRATEGIC INTENT

Effective strategic management has been described as a process of developing clear, decisive objectives, maintaining the initiative, concentrating resources for best effect, remaining flexible in the face of change, and applying coordinated and committed leadership (Quinn 1999). Most strategic planning processes involve defining a clear vision and mission to assist in guiding the firm toward its final goals (Proctor 1997).

This process of setting a clear sense of focus and direction has been described as determining the 'strategic intent' of the firm (Hamel and Prahalad 1989). This process provides a durable framework to guide strategic action and assist in leading change. Determining the corporate mission usually involves consideration of the strategic direction being taken by the firm's management, the concerns of stakeholders and the critical success factors required fulfilling the goals (Strong 1997). The possession of a formal mission or vision statement has not been found to directly impact on the performance of small firms (O'Gorman and Doran 1999).

No consistent pattern was found among the four case study firms in their possession of formal vision or mission statements. However, each of the owner-managers was found to have struggled with the strategic intent of their firms. All actively sought growth and had a strong sense of wanting to develop their firms to a point where they could be 'self-managing' to allow them to step back and let go of the daily operations. Manufacturers #1 and #2 were the most 'strategic' in their orientation. Both were better educated than the other two owner-managers but formal education and were older. While neither of these two owners was clear on the detail of how their firms would achieve their growth targets, they both held a strong sense of wanting to create organisations that were innovative, internationally focused and benchmarked, and able to secure long term customers due to their superior quality and product/service differentiation. By contrast Manufacturer #3 was a family firm with the father and son team becoming more strategic in their thinking as a result of the crisis created by their entering export markets without giving full consideration to the costs and benefits. Manufacturer #4 was female owned and operated and the owner-manager appeared to be driving hard to establish the business to a level where she could replace herself with a professional team and focus on personal, family related matters.

LEARNING BY DOING

Despite the best market analysis, resource assessments and planning the ability to accurately determine how a particular strategy is likely to unfold is limited. The 'learning school' of strategic management (Mintzberg 1998) sees strategic management as a process in which the firm's management engages in an incremental learning by doing (Quinn 1980). Flexibility is of significant importance in which the firm seeks to stretch and leverage its limited resources to achieve plans that may change in detail, even if the general strategy remains consistent (Hamel and Prahalad 1993). The dynamic nature of contemporary markets makes it unlikely that firm's will be able to formulate detailed strategic plans and then implement them within modification (Mintzberg 1984). The reality is frequently one in which the firm's management is engaged in 'controlled chaos' using judgment and intuition to craft strategy, frequently following emergent opportunities that had not been foreseen at the commencement of the process (Mintzberg 1987). Frequently the success of small entrepreneurial firms is likely to be dependent on their ability to revolutionize their markets or industries (Hamel 1996).

Innovation and the ability to learn faster than the competition are viewed as the key to successful strategic competition (Hamel 1998). The four case study firms generally followed the pattern of emergent strategies with the owner-managers adopting a post-hoc rationalisation after committing their firms to particular product or market decisions. However, this shifted toward a more deliberate strategy as the owner-managers became more strategically competent and their level of sophistication in strategic management increased. Manufacturer #3 was drawn into its export market after being approached by Japanese buyers who encouraged the firm to commit to ever increasing levels of resource investment with the promise of long-term gains. Manufacturer #1 was being drawn into heavy capital investments with active support from his bank, even though he had undertaken limited feasibility assessments. Manufacturer #4 expanded via acquisitions that were largely unplanned and involved competitors offering to sell out, or after being asked to consider opportunities put forward by customers. Manufacturer #2 admitted that when he first established his business he knew little if anything about how to manufacture the product, and learnt how to do so by drawing on the experience of his factory staff. Since then he has established formal innovation and new product development systems to try to secure opportunities for niche markets.

CONCLUSIONS

Despite being developed primarily for the large corporation strategic management theory appears to be applicable to small firms experiencing growth and change. The four case studies suggest that emergent strategies are likely to dominate over planned as entrepreneurial owner-managers follow opportunities seeking to secure niche positions that where they can take best advantage of their core competencies. However, owner managers of small firms will need to consider their capacity to follow particular market or product opportunities as too much diversification may find they outstrip their resources. Due to their lack of scale and scope, small firms can quickly adapt their organisational structure to pursue new strategic opportunities, but their limited resources are likely to impose limits on how far they can stretch and leverage. The strategic intent of the owner-manager is a key factor in determining the strategic direction of the small firm with enhanced performance apparently associated with higher levels of strategic orientation by the owner-manager. Due to the relative immaturity of most small firms their 'natural' state is one of learning by doing and inventing their future on almost a daily basis. Such firms, led by visionary owner-managers with a clear strategic intent and the desire for enhanced growth, can succeed if they adopt a strong focus on learning, innovation and market responsiveness.

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