

Strategic Management in Small Firms: Developing a Conceptual Framework

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ABSTRACT

This paper develops a five-part framework originally proposed by Mazzarol (2005) for understanding the process of strategic management and growth in small firms. The original paper was conceptual in nature and outlined ten research questions for subsequent research and analysis. Through an analysis of the literature, concurrent research undertaken by the authors, and the findings of a case study of a fast growth small firm, the authors examine eight of the research questions posed by Mazzarol (2005) and discuss their implications within the context of strategic decision making and growth within the small firm. The paper provides support for the original five part framework and outlines issues for future research.

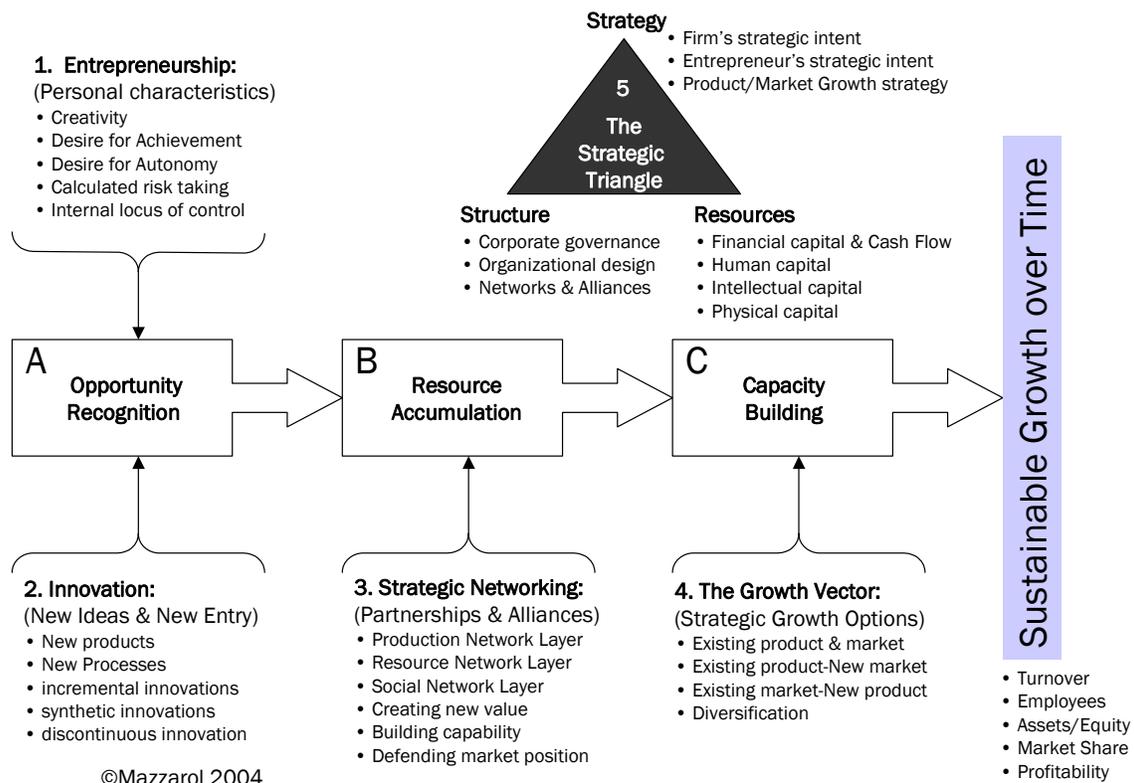
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INTRODUCTION

Small firms, which may be defined as those with fewer than 250 employees and less than \$50 million in annual turnover (OECD, 2004), typically comprise the majority of businesses within most economies, and make a significant contribution to their national economies. For example within the 21 countries that comprise the Asia-Pacific Economic Cooperation (APEC) forum small firms comprise over 98 percent of all enterprises, generate 60 percent of all private sector employment, 30 percent of all export activity and 10 percent of foreign direct investment (APEC, 2003). The sustained growth of small firms is therefore important to the long term economic prosperity of many national economies. However, for the majority of small firms growth at significant levels remains either unachievable or undesirable (GEM, 2005). This choice of whether to seek growth or to plateau the business at a particular point is a strategic decision that appears to be driven in part by the mindset of the owner-manager within the firm (McMahon, 1998; Moran, 1998). The owner-manager of the small firm needs to possess entrepreneurial traits, technical and managerial competencies, the ability to set clear vision for future growth, and to develop competitive strategies (Baum, Locke & Smith, 2001). However, it may also be constrained by external factors such as access to finance (Barton & Matthews, 1989), the ability to secure access to networks (Ostgaard & Birley,

1994), capacity to innovate (Freel, 2000), and the ability to manage growth (Berman, Gordon & Sussman, 1997).

Mazzarol (2005) outlined a five part conceptual framework for understanding the strategic management of small entrepreneurial firms. This framework is illustrated in Figure 1. It is built around the three-part entrepreneurial process of opportunity recognition, resource accumulation and capacity building (Shane & Venkataraman, 2000) and focuses on sustainable growth as an outcome. The five elements contained in the framework include: i) entrepreneurship, specifically the personal characteristics of the owner-manager; ii) innovation, or the ability to harness new ideas or new market entry to secure points of differentiation; iii) strategic networking via partnerships and alliances; iv) the growth vector, being the selection of product-market combinations for growth; and v) the strategic triangle, which recognises the need to balance strategy with structure and resources (Mazzarol, 2005).



Source: Mazzarol (2005)

Figure 1: Strategic Management of Entrepreneurial Ventures Framework

In the original paper Mazzarol (2005) identified ten key research questions that would need to be addressed within any future research. This paper will examine eight of these questions, drawing upon previous related research into small firms, innovation and strategic management, as well as the preliminary findings from a series of case studies drawn from fast growth small firms. The paper initially reviews the role of the entrepreneur and growth orientation, and then examines the nature of innovation and the function of strategic networking. It then reviews the process of strategic management within a growth oriented small firm case study. The eight research questions to be examined are:

1. What are the personal characteristics of entrepreneurs who manage fast growth entrepreneurial ventures and is there a pattern to be found?
2. What is the relationship between entrepreneurial tendencies and opportunity recognition within the basic entrepreneurial process?
3. What are the characteristics associated with innovations as found among fast growth entrepreneurial ventures and is there a pattern that defines them?
4. What is the relationship between these innovations, the entrepreneur and opportunity recognition within the basic entrepreneurial process?
5. What are the key features of strategic networking by entrepreneurs within fast growth entrepreneurial ventures across the production, resource and social network layers, and what is the strategic intent of such strategic networking?
6. What is the relationship between strategic networking, the entrepreneur and resource accumulation within the basic entrepreneurial process?
7. What is the pattern of strategic management within fast growth entrepreneurial ventures in relation to the strategic triangle?
8. What is the relationship between the strategic triangle, the entrepreneur, the innovation, strategic networking, the growth vector and both resource accumulation and capacity building within the basic entrepreneurial process?

METHODOLOGY

A single-case study approach was employed in this study. Case study method enables the researcher to examine the reasons why certain decisions or courses of action were taken, how they were implemented

and what the outcomes were. Yin (1994) defined the case study as an empirical enquiry that investigates a contemporary phenomenon within its real life context when the boundaries between phenomenon and context are not clearly defined. Therefore, the case study approach is useful when a phenomenon is broad and complex, a holistic, in-depth investigation is required and a phenomenon cannot be studied outside of the context in which it occurs (Benbasat, Goldstein & Mead, 1987; Bonoma, 1985; Feagin, 1991; Yin, 1994). The owner-manager was interviewed using a case study protocol developed specifically around the five part framework outlined by Mazzarol (2005). All discussions were taped and fully transcribed and subsequently coded. The case study approach is considered to be an effective research strategy for answering research questions of a 'how' and 'why' nature that do not require any control over the events of interest (Robson, 1993). This case study is the first in a series of cases that the authors will undertake in order to assist in evaluation of the framework.

THINKSMART – A CASE STUDY IN SMALL FIRM GROWTH

The case study firm selected for this study THINKSMART is a pioneer in the field of leasing and financing to small businesses and was listed in the BRW Fastest Growing companies list over four consecutive years. Founded in 1996 to provide point of sale, small business financing with a focus on computer and office equipment leasing, the company's initial product was RENTSMART which is now offered via major retailers throughout Australia, United Kingdom and Spain. Headquartered in Perth, Western Australia the firm has an office in Manchester UK for its European operations. THINKSMART has recently launched SMARTCHECK, a finance management system targeted as small firms. SMARTCHECK is portable, scalable, proprietary finance approval software, offering on-the-spot finance approval that is competitive with existing credit card and cash purchasing systems. It operates via web-based, or telephone supported technologies offering multilingual, 24 hour 7 day per week service and timely approval. THINKSMART is led by founder, Ned Montarello, who won "Australian Entrepreneur of the Year 1998", and a Board comprised of Steven Penglis, David Griffith and Curt McDonald, all with extensive background in financial services and merchant banking. The company has formed strategic

alliances with major retailers such as Coles Myers, Woolworths and Dick Smith Group in Australia, and Dixon's PC World and PC City in UK. It also has a significant alliance with the ANZ Bank, Bank of Adelaide and HBOS Bank (UK). The ANZ is now a major shareholder in the firm, and it has a joint venture with HBOS in the UK/EU markets.

THE ROLE OF ENTREPRENEURIAL CHARACTERISTICS

The entrepreneurial orientation of the owner-manager or entrepreneur within the small firm is the first key element identified in the framework. The psychological characteristics of the manager-owner appear to play a major role in determining the strategic intent of the small firm (Mockler, 2003, Bruch & Goshal, 2004, Heunks, 1998). For example Bruch and Goshal (2004) proposed that one key element could be the level of willpower managers bring to their job. They suggest that managers often confuse action with accomplishment and motivation with leadership. According to Bruch and Goshal (2004) the majority of managers in large organisations are prone to procrastination, and to becoming emotionally detached from their work. Successful management behaviour is more often linked to the manager's ability to harness their energy and willpower, focusing upon achievement of specific goals.

For owner-managers within small firms the desire to adopt a pro-active entrepreneurial stance appears linked to their psychological characteristics (Palmer, 1971; Kotey & Meredith, 1997; Moran, 1998). These may also be an influence on how they undertake strategic planning within the firm, whether they are opportunistic or reactive (Frese, van Gelderen & Ombac, 2000). The owner-manager's ability to deal with uncertainty within their external environment may also determine how they react to opportunity. Faced with uncertainty, managers can either adopt highly structured approaches to strategy, or they can act in an intuitive manner, perhaps taking calculated risks (Mockler, 2003). Innovativeness and creativity have also been found to be psychological characteristics that can serve as important elements of entrepreneurial success (Heunks, 1998).

In the case of THINKSMART the entrepreneurial leadership of Ned Montarello is evidenced not only by his recognition as “entrepreneur of the year”, but in his background. Lacking a formal education, he places much emphasis on forging strong alliances with competent, professional people who can assist him in managing his ventures. Despite surrounding himself with a good team, he was ultimately backing his own judgment in the early years. As he explained:

So going from a one-person show to even until it was 100% mine, was really entrepreneurial and I had a lot of people around me, but they... would come into my office and it would be an open office. It was still very much if I wanted to do it I would do it...But it would be on how empathetic or open the entrepreneur is on ideas, how accepting they are of the input of their staff that allows that business to grow. If it's just one person owning the business it may be different. I'd like to think that I was very open, but I was smart enough to recognize the risk in that. So I think that we had a very strong group.

This translated into the creation of a strong Board of Management as the business expanded, to assist in the strategic management of the company:

If you have a strong board who challenge you then the business can just go anywhere. So I really welcomed that structure. It wasn't me letting go of my baby, it was just quite the opposite. I felt really quite liberated...so your choice of partners at that critical stage is absolutely fundamental...The business has grown for the past three and a half years, you know we've been one of the top 100 growing companies in Australia for four years...when venture capital comes in, they typically come in because something has been going right with this business...so when I went out and got the shareholders involved, what I was looking for was the money and a strong board.

Although the company took on venture financing and a strong management team, the overall entrepreneurial leadership remained with Montarello, “there's only one entrepreneur in this business”. It was nevertheless important for him to build a strong team of specialists in key areas such as accounting, sales management and operations management, who could provide the skills and competencies that he knew he lacked. An important aspect of his management style was not to view failure as an end, only as an opportunity to learn. His management team were also a useful source of learning for him: “I'm learning as much from these guys as they are from me...And that's the balance”. He also considers a major source of motivation for him is his family (he has two sons), and his desire to create new things: “personally, I just love building...I like growing”. This was a major source of personal satisfaction.

Montarello's desire to create new business opportunities and growth has been mentioned, and appears to have played a key role in shaping the strategic intent of THINKSMART. In seeking to grow the company needed to spot new opportunities for market development, and to secure a foothold in these before the window of opportunity closed, a key to this was securing access to good market intelligence:

And that's what an entrepreneurial business to me is all about. It's about being nimble and able to capitalise on opportunities. And that's what I think our business is. And that's information.

In many respects this would require taking calculated risks:

If you try and go into a new industry, you will need to get all that information. And it will take six months or a year etc. When you go into a new market place, that's a risk, and that's a calculated risk. And everyone is going to take a position and say you know what we can't minimise exposure here, we can recognise the exposure, and we then take the position, which is what we did, and then commit. And this is what the upside is.

In seeking to answer the first two research questions the findings from the THINKSMART case highlight the importance of the personal drive and commitment of an entrepreneurial leader or leadership team to the business's growth. Opportunity spotting and the willingness to exploit such opportunities appear to be strong hallmarks of such entrepreneurial leaders. Truche and Reboud (2004) and Truche, Reboud et.al. (2006) examined the nexus between entrepreneurial orientation, opportunity recognition and growth suggesting that the key elements needing to be considered were strategic intent, path dependencies and the managerial psychological characteristics of the entrepreneur. Their analysis of four small business case studies identified deliberate, planned strategies, and also emergent, opportunistic strategies. These owner-managers sought to fit their respective skills and resources to identified market opportunities. These differences were identified as explainable with reference to the respective initial conditions, including the owner-manager's culture and psychology. In the case of Montarello and THINKSMART these same characteristics can be identified. His willingness to follow emergent, opportunistic strategies with a strong international focus to secure the required growth is consistent patterns of behaviour.

THE ROLE OF INNOVATION

The second key element in the framework is innovation, or the ability to generate commercial value that is original and can be used as a point of difference in the market. Innovation is a complex construct to define but is usually associated with ideas leading to new products or new processes, or the synthesis of existing ideas to create new market opportunities (Tushman & Nadler, 1986; Drucker, 1985). Radical technological innovation is typically associated with the implementation and commercialisation of new products or processes that offer significant benefits to consumers or that can significantly enhance production or delivery methods (OECD, 2001). Within small firms innovation can involve new product or process technologies, but might also involve the entering of new markets, the adoption of new marketing methods, or the application of new technologies to administration (North & Smallbone, 2000).

For THINKSMART their success was based in part on innovation in products (e.g. SMARTCHECK), and partially on the innovation that it brought to business processes (e.g. RENTSMART). The company found a solution to the problems facing the small business consumer, the large banking corporations who finance them and the electronics-computer retailers who seek to supply the latest technology to them. While the software that makes SMARTCHECK is a valuable intellectual property, it was insufficient in itself to create the successful business model that has helped the company's growth. This technology needed to be matched to the RENTSMART business financing system with its point of purchase marketing networks. Of critical importance was the ability to link the major retailers and the major financial service providers together within the business model.

In addressing the third and fourth research questions the THINKSMART case can be compared to the findings of other research undertaken by Mazzarol and Reboud (2004; 2005; 2006) who examined the findings from a study of 57 small, high innovator firms and an analysis of eight case studies of entrepreneurs from small firms seeking to commercialise new technologies. Their findings suggest that the nexus between innovation, the entrepreneur and opportunity recognition within the basic entrepreneurial process is likely to be driven within small firms by the response of leading customers to innovation rather than a more fundamental research orientation driven by scientific or technical inquiry.

For example, over 91 percent of entrepreneurs within the small innovator firms reported leading customers as having a strong influence over strategic decision making relating to innovation (Mazzarol & Reboud, 2006). The possession of a formal new product development (NPD) was found to be associated with enhanced innovation. In the case of THINKSMART the pattern of activity was similar, with an emphasis on market or customer led innovations across product, process and marketing areas. While there was a good deal of technology development in the SMARTCHECK software, the majority of the innovation was in the RENTSMART concept of delivering cost-effective leasing finance solutions to small businesses at point of purchase.

THE ROLE OF STRATEGIC NETWORKS

The third element of the framework is strategic networking. Strategic networks are associations (both formal and informal) between firms that are typically of long-term duration, and are forged in a purposeful manner in order to gain or sustain competitive advantages over competitors that lay outside the network (Jarillo, 1988). The small firm can use strategic alliances for accessing new markets and the creation of new value, developing existing capabilities through the acquisition of resources, or defending market position (Jarrett, 1998). Strategic networks can also be found on at least three levels: i) the production network associated with supply chain relationships; ii) the resource network, typically associated with third party resource providers such as banks or collaborative research partnerships; and iii) the social network, which is associated with the entrepreneur's personal contacts (Holmlund and Tornroos, 1997).

In a study of 73 highly innovative small firms engaged in the Australian ICT sector Mazzarol (2003) found that strategic partnering with leading customers and key suppliers were considered to be far more important than the formation of alliances with third parties in the resource network. Further analysis of a sample of 113 small firms in a range of high technology industries found similar results (Mazzarol, 2004). Strong partnering with leading customers and key suppliers via the production network was felt to be of much greater benefit from a financial perspective by these small firms, than strategic partnering via the resource network. Rogers (1995) showed that a customer's acceptance of an innovation was influenced

by five key elements: i) the perceived comparative advantage of the innovation; ii) its complexity; iii) its compatibility with existing techniques and technologies; iv) its ability to be trialled prior to adoption and v) how observable its benefits are.

In the case of THINKSMART the growth of the business was closely associated with the firm's ability to form strategic alliances with such groups as Coles Myers, Woolworths, Dick Smith Group and Dixon's, PC World in retailing, and ANZ and HBOS Banking Groups in the finance sector. It took Montarello much longer than he had originally planned to secure these alliances. For example, the alliance with Dixon's is a formal joint venture and places THINKSMART into partnership with one of the largest retailers in the EU. Originally planned to take place in 1999 the formal merger did not take place until 2002 and required Montarello to spend six months each year in the UK and Europe away from his family. While he described the experience as "exhilarating, challenging and stressful", it was also a major drain on his finances and personal life. For Montarello the key to success in such alliances is the ability to offer value to the alliance partners, and to build trust and strong relationships, for example he describes his experience of trying to secure the alliance in the UK:

And I remember the conversation I had with this particular chap. It was something along the lines of, Derek, you're a hard man to catch, I know you know a bit about my business, look I've emailed you and I've had a quick response from your P.A. We're coming to the UK and will launch it, I want to launch it with the largest retailer and I hope that that is going to be you. Can we have 20 minutes because I'll come across specifically with the legal work? So I'm just letting you know why we're still asking about you...you've got a guy on the other end of the phone who is a £15 billion organization and really what is he looking for? He doesn't really care if we're the top 100 growing in Australia. He doesn't really care if I won an award or if I haven't. What he cares about is – he is looking for an edge – so if I can give him something that might actually do this and make a breakthrough for him...that's the sort of zone.

The decision to form a strategic alliance within the UK and EU was taken in part by THINKSMART as a means of reducing the overall risk of entry to these markets and as part of an overall strategy for growth:

What we did in the UK was we thought the exposure was too big, and we thought the better way to minimise exposure is to joint venture...So you reduce the risk from the outside, but it allows us now as a footprint to go on to the rest of Europe, and we don't have to do that at the bank, we can do it ourselves without anybody else so it's just one step on top of the other.

This ability to make the innovation attractive to the leading customer appears to be a key element in the successful small firms. In addressing the fifth and sixth research questions the THINKSMART case highlights the strength of the production layer alliances (e.g. with retailers), but also the need for resource network alliances (e.g. with the banks) in order to develop a strong business case. The strategic intent of such alliances on the part of the small firm is to secure access to markets and resources, while their larger alliance partners view the relationship in pragmatic terms. It is important for the entrepreneur to sell the benefits or value in the relationship to the alliance partners. This is consistent with the findings of other research, for example, Reboud and Mazzarol (2006) found that the owner-manager's decision to invest in the innovation was strongly influenced by their leading customer's willingness to adopt the innovation, and that this was influenced by the same factors identified by Rogers's original research. Small firm innovators were found to be willing to partner with other firms and forge partnerships with complimentary actors when the complexity of their innovation increased beyond the level they could handle alone, and where the adoption of their innovation by their leading customers was likely to be placed at risk because of this. However, the owner-manager's decision to engage in a strategic network was influenced by their perceived ability to maintain control over the innovation process. Reboud and Mazzarol (2006) also suggested that these factors are relevant for an innovation's diffusion by a small firm, and that the complimentary actors are of high importance when complexity increases. Those actors seem to act as prescriptors of the innovation to help the diffusion.

These findings are consistent with those of Murray (1991), who emphasised the importance of innovation to lower risk when adopting an innovation. The importance of networking and the difficulty for small firm owner-managers to build and manage such networks has also been also highlighted by Julien et.al. (2002), Deslandres et.al. (2004) and Gutierrez-Segura et al (2004), who suggested that the small firm should develop specific competencies including the ability to build on interpersonal networks, and the use of Word-Of-Mouth (Brown & Reingen, 1987), and the ability of learning by interacting (Lundvall, 1998). In summary the diversity and richness of such networks rely on the ability of the small business owner-

manager to build them, they constitute then a strategic resource and a very important source of information, knowledge and advice for the manager (Hogberg & Edvinsson, 1998).

THE PROCESS OF STRATEGIC MANAGEMENT

The final element to be examined is the overall strategic management of the venture. An initial starting point is to examine the concept of strategic intent. The concept of “strategic intent” was introduced by Hamel and Prahalad (1984; 1994) as a mechanism for establishing a missing link between business activity and management strategy. Within this context, strategic intent can be viewed as a guide, inspiring strategic thought and structures in a dynamic manner and defining the strategic goals, the selection and configuration of resources and the operational modes within the firm. Strategic intent might be seen as the succession of cumulative strategic decisions that guides the business model in a manner that achieves a sustainable competitive advantage for the firm within a definite context. MacMillan (2001) for instance suggested that strategic intent is created under influence: “strategic intent describes what the enterprise means to become in the future”. Strategic intent will thus outline the vision of the enterprise in the future and set goals to be achieved. Within the strategy formulation process leaders, stakeholders, and context, all influence strategic intent. Strategic intent depends on the differing aspirations of stakeholder groups, particularly the most powerful.

In a small firm strategic intent will mainly reflect the aspirations of the owner-manager or entrepreneur. Strategic intent may also be influenced by the history of the enterprise and its ownership structure. Whatever the strategic intent of the entrepreneur, their ability to pursue a recognised opportunity is likely to be contingent on a range of influencing factors that can lead to path dependency. Chersbrough (2003) suggested that a firm’s choice to access these resources are likely to exert path dependent influences over subsequent entry behaviour into new-submarkets. For example, Gans and Stern (2003) found microeconomic and strategic conditions facing a firm as an important influence factor. Littunen and Tohmo (2003) found that the strategic alliances and cooperative networks can enhance the survival of start

up firms. Other path dependencies may include, the geographic region in which the firm is operating (Karlsson & Dahlberg, 2003), or technologies utilised by the business (Marsili, 2002; Koskinen & Vanharanta, 2002; Constant II, 2002; Dosi, 1982 & Arthur, 1989).

In this context the strategic vision and purpose of THINKSMART was an important part of the entrepreneurial process. As noted above, Montarello was motivated in part by his desire for growth within his business, and also the opportunity to offer his innovation to his leading customers. His strategic intent was therefore successful growth rather than simply the achievement of a lifestyle. To achieve this growth he sought to build a strong management team around him, and to share equity within his business with both private and institutional investors. Furthermore, the international growth of THINKSMART has been dependent on the establishment of formal strategic alliances and joint ventures with major partners in the UK (e.g. HBOS Bank and Dixons). This has placed a pressure on his personal life, but he is driven by the desire to succeed:

So, I'm torn because the motivation for me is every time I'm involved in business when I'm overseas, is seizing the opportunity...because you're so focused. You've just got to get it built, you know, and then put some smart people behind it and they can get on with it.

In his management style Montarello places much emphasis on “managing the expectations of his staff”, which he describes as “a balancing act”. From a strategic decision making perspective his decision to enter the UK and later EU markets was driven by the size of these markets (“I want economies of scale”) and the need for the end user market to be similar to that found in Australia (“will buyers want to rent equipment or do they want to buy?”). In assessing which international markets to target THINKSMART uses feedback from the market at several levels to assess the potential performance of its products and the strategic opportunity that is offered, as Montarello explains:

I know my product works when I've got the same tax scenario as here in Australia. I know my product works when I've got a hyped small business community. I know my product works when there's a high rate of technology change, I know my product works when there's a centralised credit bureau that I can source information from. That's all I need. Now, that to me, in principle, if someone says what about Slovakia. Then I'll go through those four. I'll get that from a phone call. Then I'll put some meat on the bones of that, I need to flesh it out. That won't take more than a month or two. And then I'll know well that becoming quite workable, and I can go.

This strategic management behaviour by THINKSMART illustrates the firm's management's balancing of both the strategic growth, structure of the venture (e.g. forming joint ventures, setting up alliances) and securing access to resources. In addressing the final two questions the case study supports the concept of the "Strategic Triangle" outlined by Mazzarol (2005), in which there is a need to balance the strategy, structure and resources as the firm grows. It appears as an opportunistic, emergent strategy approach in which the entrepreneur works in close contact with leading customers, key suppliers and other strategic alliance partners, to secure the resources to follow the strategy. In doing so the firm must continuously form new structures to succeed.

CONCLUSIONS

The findings from the THINKSMART case are consistent with those from a study of strategic thinking and behaviour among 21 small business owner-managers (Mazzarol, Reboud & Tye, 2006; Mazzarol, Reboud & Olivares, 2006). This longitudinal study suggested that the owner-managers of small firms must balance strategic thinking with operational management and that small firms have three strategic options: i) growth; ii) lifestyle and iii) exit. Growth firms need visionary leadership, willing to accept risk and with the creative drive to pursue innovation. Lifestyle and exit strategies require the owner to possess management skills and the ability to administer systems. All these qualities are highlighted in the THINKSMART case.

The THINKSMART case provides some initial support for the five-part framework originally proposed by Mazzarol (2005) and is broadly consistent with the findings of other research into small firms. Further analysis of additional case studies will be needed to produce a convincing pattern, although the role of the entrepreneur, their commitment to growth, and capacity to diffuse an innovation via strategic alliances with leading customers and other network partners seem logical. For academic researchers the study highlights the importance of focusing on the

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entrepreneur, their strategic intent and capacity for strategic networking, as key elements in understanding small firm growth. Entrepreneurs should in turn focus on the need to not only secure a valuable innovation, but the need to diffuse it into target markets via a strategic network and the balancing of strategic intent, with resource accumulation and structural flexibility.

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