

PARTNERSHIPS – A KEY TO GROWTH IN SMALL BUSINESS

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ABSTRACT

The conventional image of the small business owner is that of a highly independent individual, taking risks and 'doing it tough' with limited assistance from others. However, research conducted in the United Kingdom and Australia with high performance small firms suggests that this is not so. A multivariate data analysis of the relationship between business management practice and sales growth performance identified the importance of partnering. This refers to the process of working in partnership with people who affect the business. Partnering involves creating and maintaining partnerships with everyone who affects your business. Working in partnership involves the creative talents and energies of everyone who can affect your business. The effect is that everyone, from staff through to supplier and customers, works together for mutual gain. These findings suggest that the owner of a small business needs to view himself or herself less as a lonely, isolated battler and more as someone who can gain from partnering. A willingness to seek strategic alliances can prove a valuable source of potential growth for small firms.

THE GROWTH CYCLE OF SMALL FIRMS

Small to Medium Enterprises (SMEs) comprise the largest proportion of businesses in most economies and frequently offer the greatest potential for job creation (Asquith and Weston, 1994). For example, in the United States small businesses employing less than 20 people were the major source of new jobs during the late 1980's (Phillips, 1993). A similar pattern was observed in Canada where the fastest growing sector of the economy was that of SMEs (DeLaurentiis, 1994). In Australia, SMEs account for about half the total employment and contribute more to job creation than many larger businesses (DFAT, 1995). It is for these reasons that many Governments have begun to take an interest in the process of growth within the SME sector.

Academic study of the growth cycle of small firms has been continuing for many years (Steinmetz, 1969). Both Churchill and Lewis (1983) and Scott and Bruce (1987) have proposed five stage models of SME Growth – incorporating 1) start up, 2) survival, 3) growth, 4) take-off and 5) maturity. During the first stage the business is conceived and established. During this period, it is entirely the creation of its entrepreneur founder(s). All attention is given to finding customers and maintaining adequate cash flows to survive. The owner is the most important asset of the business, providing all its managerial skill, direction, and capital.

If it survives the business will pass into a second stage of "Survival". During this period the business is financially viable and may even hire additional staff. The owner-manager usually remains in control of the business and undertakes only minimal formal planning (Churchill and Lewis, 1983). Many SMEs continue to operate in this stage for long

periods of time, with a single or limited product line and any growth being driven by natural market expansion (Scott and Bruce, 1987).

From the perspective of growth, it is the third stage that may be most critical. Churchill and Lewis (1983) identify two sub-stages in this “Growth” or “Success” period. The first of these is that of “Success-Disengagement”. Here the business is economically strong and has sufficient size and product market penetration enabling it to sustain its current position. Its size is such as to require professional managers. In this sub-stage the owner-manager decides to either grow or not. The business is usually profitable and can either continue in its present form or even is sold at a profit (Scott and Bruce, 1987).

A successful growth strategy will take the business into the fourth stage of “Take-Off” or “Expansion”. In this critical stage the business will either succeed to develop into a big business or not. As it grows the business will become more formalized in its accounting, management and other systems. The fifth and final stage of “Maturity” or “Resource maturity”, sees the business with sufficient resources to conduct formal strategic planning. Its management structure is likely to be decentralised and there is a greater separation between the owner and the business in terms of financial and operational matters. Large-scale investment in marketing and production facilities during this stage may result in additional equity financing. Many entrepreneurs experience difficulties with pressure from shareholders over strategic directions.

FACTORS INFLUENCING GROWTH

Gibb and Davies (1992) have examined the growth process of small firms in the United Kingdom. This Durham Business School (DUBS) model of SME growth recognizes that growth is contingent upon the ‘base potential for development’ inherent within the firm. This includes the firm’s resources – financial, physical and human – as well as the experience, leadership, ideas and control base of the entrepreneur. Growth is influenced by key internal and external factors that must be considered by the entrepreneur as they move through their growth cycle.

Although successful growth within the SME is contingent upon many factors, the most important is arguably the attitude of the owner-manager (Brockhaus and Horwitz, 1985). The decision to grow is a risky one that many entrepreneurs choose not to make. For example, a survey of 1,996 SMEs undertaken by the Japan Small Business Research Institute in 1994 found 64 per cent of respondents did not wish to grow into large corporations (Kazumi, 1995). Similar findings were produced by a *Yellow Pages Small Business Index* (1995) survey of Australian SMEs that found less than 10 per cent of respondents were growth oriented.

The reasons why so many SME owner-managers should not desire growth are numerous. Concern over having to go into debt is a deterrent to many, particularly women (Taylor, 1986). Growth can also represent a loss of personal control by the owner-manager who may dislike the idea of passing the responsibility of running the business over to professional managers (Barnes and Hershon, 1976). It is important to realize that the

problems associated with growth in the SME are just as difficult as those confronting much larger firms. Effective growth strategies require careful planning, and most SMEs lack the resources needed to undertake this (Shuman and Seeger, 1986).

Perry, Meredith and Cunnington (1988) examined the relationships between the personal characteristics of owner-managers and SME growth. Their findings suggest uncertainty over all relationships except the need for achievement within the owner that was indicated as significantly associated with growth.

For many SME owner-managers the decision to growth is fraught with problems (Bosworth and Jacobs, 1989). Inadequate management skills, particularly in strategic planning, can serve as a deterrent (Scase and Goffee, 1985; Boswell, 1973). Access to finance has also been identified as a major impediment to SME growth in businesses requiring it for R&D (Jones, 1992). The inability of the SME to seek out sources of information and technology needed for growth has also been found to act a potential barrier (Rothwell and Beesley, 1989).

According to Jones (1992) most barriers to SME growth are found inside the business. These include a lack of technical and managerial skill, inadequate organisational adaptability, and ability to acquire or use technology.

THE POWER OF PARTNERING

The lack of resources experienced by most SMEs suggests that substantial benefits might be obtained through the development of partnerships or alliances with other organisations likely to make up any shortfalls. Growth for the small firm that seeks strategic partnerships is likely to be greater than among those that do not (Wendy, 1997). For example, a Coopers & Lybrand study of 400 high growth small firms found that those with strategic alliances experienced growth rates 20 per cent higher than firms without such alliances and around 11 per cent more sales turnover (*Small Business Reports*, 1993).

In a study of small, black-owned businesses in the United States, Brown (1996) identified a 37 per cent faster growth rate among small firms that used strategic partnerships than those that did not. A further study of 451 small retail firms in the Netherlands found that membership of a strategic alliance had a positive influence on the business. Such firms were generally more profitable and took a more 'professional and active' approach to marketing (Reijnders and Verhallen, 1996).

Dent (1990) suggested that strategic partnerships would be essential for success in the future. The need to develop 'networks' capable of delivering economies of scale and greater market penetration were seen as important. However, he also pointed to the need to maintain flexibility within such alliances for the participants. For manufacturers the importance of developing mutually beneficial relationships with buyers is likely to be a critical success factor (Holmund and Kock, 1996).

Strategic partnerships enable SMEs to achieve greater levels of product innovation and can assist with expansion into new market segments when faced with rapidly changing external environments (Maynard, 1996). This is due to the benefits the firm can receive in the form of external information via its network of strategic partners. Flexible, informal networks can be just as beneficial as more formal ones (Malecki and Tootle, 1996).

For SMEs that lack the substantial resources available to the larger firm, network organizational structures built around strategic partnerships offer an alternative to vertical integration models (Larson, 1992). There is evidence in the United States of small firms using strategic partnerships with large corporations to secure access to new technologies, wider distribution networks and marketing expertise (Gilbert, 1991). This has been particularly noticed among small high technology firms that have developed partnerships with University research institutes and customers in collaborative research agreements (Forrest, 1990). However, such partnerships need to be carefully prepared to ensure that the larger partner does not dominate or stifle the very innovation it seeks from its smaller partner (Doz, 1987).

THE VALUE OF PLANNING

Despite their importance, strategic partnerships are not the only ingredient in SME success. Other key success strategies are – providing value, reliability, good service, excellent quality and developing long-term relationships with customers (Simon, 1996). Success among small businesses has also been associated with – an ability to use financial data, knowledge of accounting practice and support from family (Kaufman, Weaver and Poynter, 1996). Management experience and education have also been found to be positively associated with SME success (Sage, 1993).

The role of strategic planning within SME success has also been emphasized. Lack of planning is frequently associated with failure, while growth requires careful financial planning to ensure they have adequate funds to support their market development (Brazell, 1996; Nelton, 1992). Strategic planning within SMEs is frequently informal and dominated by the owner-manager (Ghosh and Chan, 1994). The importance of formal planning to success within SMEs is the subject of continuing debate (McKiernan and Morris, 1994).

A study of 500 small firms in the United States found that those experiencing growth were distinguished from those experiencing decline by the presence of a formal written business plan (Jackson, 1994). The value of formal business plans has also been noted among small high-growth firms where such plans appear to be used more for internal management than external financing, planning and profitability appear to be linked (Baker, Addams, and Davis, 1993).

THE RESEARCH

During the late 1980s a research program was undertaken by the Small Business Centre of the Durham University Business School into the growth process of successful SMEs (Hall, 1992). Using a sample of firms representing service, manufacturing and retail sectors from the Northeast and Southeast of England a comprehensive examination was made of their business practice over time. A final sample of 30 high growth firms were selected and studied. This took place in three stages. During the first stage in-depth interviews were undertaken with the managing directors who identified key areas for future research. During the second stage the growth cycles of the firms were examined in detail to understand what common characteristics existed between the firms. In the final stage a comparison was made of the factors which commonly characterised these firms. A follow up interview was undertaken to examine specific issues.

What emerged from the study was the identification of six key areas of successful business performance. These six areas are:

1. **Focus/Direction** - Fashioning and managing the overall focus and direction of the business
2. **Customerising** - Continually delighting the customers
3. **Partnering** - Working in partnership with people who affect the business
4. **Personality** - The character of the business
5. **Quality** - A commitment to providing product quality and customer service
6. **Systems** - Establishing systems to provide information to empower decision-makers (Hall, 1992).

In 1997 the Small Business Unit of Curtin Business School commenced a study designed to test the validity of the original Durham research using empirical analysis. A questionnaire was developed which measured the perceptions of SME owner-managers as to their current performance on the six dimensions identified in the Durham study. The questionnaire contained 180 items measuring the six dimensions and used a five-point Likert scale. Additional questions measured business planning, future intentions, and the firm's financial performance in terms of annual sales and gross profits over a four-year period.

An original sampling frame of 500 firms was identified and approached over their willingness to participate in the study. The owner-managers of 88 firms were surveyed as to their perceptions of the current level of business practice within the firm on six dimensions of business performance. Fifty-three firms returned useable surveys. These firms were drawn from all industry sectors with manufacturing (24.5%) and retailing (23%) making up the largest sub-sectors.

Just fewer than half the sample (48%) had less than 10 employees, although only 10 per cent had more than fifty. Most of the respondents had been in their firms for at least 6 to 10 years. Eight per cent had been operating for over 20 years, twenty-five per cent for

over 10 years and thirty-three per cent for less than 5 years. The average age of the owner-managers in the sample was between 20 and 40 years with less than half (47%) aged under 40 years. Few of the respondents (10%) had been educated beyond senior high school level. Only 12 per cent indicated they were engaged in exporting. This profile is largely consistent with that of the true population of small business in Australia (ABS, 1997).

ANALYSIS AND RESULTS

A stepwise discriminant analysis was used to examine the relationship between performance on the six-factor model originally identified by Durham and the firm's sales growth. The dependent variable in this analysis was an index of annual growth in sales over a four-year period. This was derived from the actual sales figures supplied by the sample for the previous four years. Two sub-populations were identified within the sample – those with annual sales growth of less than \$320,000 over the four-year period and those with sales growth in excess of this.

The discriminant function that differentiated the two groups was found to be significant at the 0.05 level. However, only one of the six dimensions of business performance was found to be significant at the 0.05 level. Table 1 shows this variable.

Table 1: Final Variables in the Discriminant Analysis
Standardised canonical discriminant function coefficients

<u>variable</u>	<u>Function 1</u>	<u>Wilk's Lambda</u>
<i>Partnering</i>	.586	0.734

F statistics were computed from the relevant Mahalanobis distance measures to determine whether or not the two groups were significantly different to each other. Both groups were found to be significantly different at the 0.05 level. A total of 79 per cent of the low growth firms and 74 per cent of the high growth firms were correctly classified. An overall 76 per cent of firms were correctly classified in the model.

These results suggest that while the other five dimensions of business performance are important, there appears to be a special relationship between partnering and business growth in the sample. It should be remembered that partnering involves the development of strong working relationships with the firm's customers, staff, suppliers and support networks.

Additional analysis was undertaken using a *t*-test procedure to examine the relationship between the other independent variables in the model and the dependent variable. This found a significant relationship (at the 0.05 level) between high sales growth and the following business performance characteristics:

- A high level of environmental scanning
- A greater than average control over their key resources – e.g. financial, human, physical.
- A stronger than average level of customer commitment
- An organisational structure that supports their business plan
- **A commitment to partnering with customers & suppliers**
- A strong commitment to ISO9000 standards
- A clear knowledge of the critical information required to daily manage the firm
- Good cash flow management
- A commitment to taking action

THE IMPLICATIONS

The size of its sample and the use of sales growth as a dependent variable limit this study. A more robust measure of growth is required to fully examine the causal relationships between it and the six business performance dimensions. Despite these limitations the findings of this study support the original Durham University research and highlight the overall significance of strategic partnerships to successful business performance. As noted earlier in this paper, the power of partnering is recognised by a large body of previous research.

The dimension of 'Partnering' examined in this study is comprised of five areas – 1) structure/roles, 2) customer partnerships, 3) staff partnerships, 4) supplier partnerships and 5) support network partnerships (Hall, 1992). The first area concerns whether the firm's organisational structure is correctly configured to incorporate the partnerships that it needs to establish and maintain. If the owner and other staff are not spending enough time engaged in the correct partnering activities roles may have to change. For example, how much time do owners spend with their key customers?

Developing partnerships with customers, staff, suppliers and support networks (e.g. accountants, banks, local chambers of commerce) requires a constant effort by small business owners. However, long term benefits of such partnering can be substantial. The key ingredient to making partnerships work are – commitment, adopting a 'win-win' attitude, having a long-term outlook, being open and honest, developing mutual trust and seeking an integration of effort in terms of information and systems (Hall, 1992:104).

SMEs facing a growth cycle will require external funding and assistance from a potentially wide range of strategic alliance partners. Few small business entrepreneurs have the resources, management skills and access to markets required to successfully complete all their objectives. However, through the establishment of partnerships they can multiply their resources without the substantial costs that would otherwise be required.

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