Business Strategy – do SMEs face special problems?

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Abstract

This paper records the findings from business strategy development exercises, carried out in twenty seven small to medium sized companies (SMEs). In particular the question is addressed as to what are the issues that are particularly relevant to SBUs undertaking the task of planning for the future.

Three major conclusions are drawn. The first is that, in the main, SMEs only undertake a strategy review when forced to as the result of some major event. Second the evidence from such reviews is that the SBUs are in fact collections of businesses rather than a single homogeneous business. This fact is not always well recognised by management. Third the SMEs do not readily understand their markets. This can lead to them making unrealistic plans and forecasts.

Key words

Business strategy development, Small to Medium Sized Businesses, decision making tool

1. Introduction

There seems little evidence in the literature of studies made of the issues that influence small to medium sized businesses (SMEs) trying to develop a business strategy, through observing the actual process. In particular are there factors that can be identified as being specific to SMEs? Equally what are the triggers that make SMEs undertake such an exercise, apart from the need to plan their future?

This paper looks at the findings from work carried out in twenty seven SMEs, who were trying to develop a strategy for their business. They all used a computer based decision making tool in a workshop context. Data from one of the SMEs is incomplete.

The tool was originally developed within the Institute for Manufacturing but it has since been marketed commercially. All but three of the findings are taken from these commercial exercises. They were thus generated within a business setting. This had two advantages. The first was that the companies were expecting an outcome that would benefit their business. They required the strategy development process to be undertaken in a professional way. They were therefore not prepared to tolerate the sort of problems that can occur in research or development programmes. Thus the conclusions reached in the paper are likely to reflect the reality of their situation.

The second advantage is that the structure of the tool has been relatively stable over the entire time the exercises have been carried out - around five years in all. A major change was made when the embedded methodology was extended to include service companies. This involved the adoption of a more general market model (see section 2 below). The software was updated at that point. A second major innovation was to incorporate a facility to develop action lists within the software. Action plans had been developed informally by the facilitator, at the outset. This latter improvement left the methodology unchanged. Thus the majority of the findings are comparable. Where differences do exist they can be reconciled in the analysis. Moreover because the tool is computer based, it has a formal structure and the findings are captured electronically, mostly in numerical form.

The disadvantage of the approach is that it cannot be described as a properly controlled piece of scientific observation. The hope is that this is partially offset by the formal and repeatable structure of the workshops and the data. In addition, the major conclusions can be drawn from an analysis of this data rather than from observations made by the facilitator. Indeed the workshops have been executed by a number of facilitators.

2. The decision-making tool.

The decision support tool was originally developed through a project funded by the British Department of Trade and Industry. It concentrated on SMEs in manufacturing. There were five partners and the Institute for Manufacturing was responsible for the methodology. Two of the other partners developed the original software. The methodology was tested in ten companies (Frizelle and Gregory, 1996).

Subsequently a company was set up to exploit the methodology and the software rewritten to meet the demands of a commercial environment. It is now marketed under the proprietary name of Focus Strategy Management. At the same time the methodology was extended to cover SMEs in the service industries.

The basic methodology is to match how the company wishes to develop, to what the market is looking for. This is achieved by identifying the relevant competencies that the SMEs have to develop (Hax and Magluf, 1996). There are five stages, and they are carried out in a series of workshops managed by a facilitator, preferably someone from outside of the company. The workshops are attended by the senior management team. It is important that no major player is missed out of the workshops and that the sessions are conducted without interruption.

The Business Analysis Stage.

During the first stage, information is gathered about products and product groupings and the markets in which they appear. Based on this information the SME is divided into a number of strategic business or planning units (SBUs) for subsequent strategy development. In terms of hierarchical development of strategies, this corresponds to the corporate level (Hofer and Schendel, 1978). Thereafter each strategic business unit (SBU) is analysed in isolation. This corresponds to the company level in the hierarchy.

The Strategy Development Stage

During this stage, the management team decides on the strategies it wishes to pursue for the future development of the selected SBU. It then contrasts them with the current strategic emphasis. This is a useful consistency check as a major change of direction can involve the company in significant investment.

Market Focus Stage

Here the team reviews its perception of market place requirements and how competitors behave. These are matched to a market model proposed by Treacy and Wiersma (1997). It allows the participants to agree on an operating model that is appropriate for them and to see how homogeneous the marketplace actually is.

The Strategic Direction Phase

The strategic direction phase maps the strategies that management wish to pursue to the requirements of the market model. Gaps that are revealed form the basis of an action plan.

At the same time, a financial plan is developed. This covers both corporate and SBU profit and loss. In addition, a three year profit projection is made based on the strategies that management wish to follow.

The Action Plan

Here areas identified for attention in the previous stage, are examined. The primary question that is addressed is what, if any, action needs to be taken. When this has been determined; costs, timing, outcomes, measures are agreed and responsibilities assigned for their execution. The action list provides the team with the immediate steps required to implement the strategy. In particular specific competencies that need to be developed or strengthened, are revealed.

3. The Sample

In total 27 companies were analysed. However incomplete data exist for one of them. Just over half the companies had a turnover of under £ 6 million per year. The figures are given in table 1 while table 2 gives the types of industry covered. The categories are taken from the Financial Times classification for companies quoted on the London Stock Exchange. However none of the sample companies is quoted (although one was the subsidiary of a quoted company) therefore the allocation has been made by the author. It is based on identifying a quoted companies in a similar business.

Annual Turnover of company (£)	Number in the category
1 – 1,000,000	3
1,000,001 – 2,000,000	4
2,000,001 – 3,000,000	0
3,000,001 – 4,000,000	2
4,000,001 – 5,000,000	2
5,000,001 – 6,000,000	3
6,000,001 – 7,000,000	2
7,000,001 – 8,000,000	0
8,000,001 and over	10
Sample size	**26** – no records for one company

Table 1 Distribution of companies in the sample by annual turnover (the over £ 8 million entries are too dispersed to merit further categorisation)

Category of company	Number in Sample
Household goods and textiles	4
Engineering and machinery	4
Electronic and electrical equipment	2
Aerospace and defence	2
Food processors	2
Chemicals	2
Support services	2
IT Hardware	2
Software and computer services	2
Distributors	1
General retailers	1
Packaging	1
Health	1
Transport	1
Sample size	**27**

Table 2 Distribution of companies by category of business

It can be seen that there is a wide spread of business categories, leading to the view that any general findings are likely to be of broad interest.

4. Findings

A major finding (see table 3) is that, in all but four cases, the decision to undertake a strategy review was triggered by some specific event. In other words, there was usually some additional incentive for undertaking the exercise apart from the SME wanting to plan its future. The reasons are given in table 3.

The table reveals that there are two major triggers. One is that the business is being threatened by losses. In some cases, a loss was already being incurred, in others there was an imminent danger of it happening. The second trigger was an opportunity to expand, in one case this was to extend the operation overseas. Very often the expansion involves some physical relocation, either new premises or acquiring additional premises.

The third entry in the table refers to those companies where no obvious trigger existed. In these cases it had become apparent to management that the company had lost focus and/or was having difficulty being able to agree its priorities.

The remaining entries are self explanatory. It is of interest that both in the case of a new managing director arriving and of the appointment of a new team, the exercise was seen as a way to achieve cohesion and consensus within the team, as well as setting the future direction for the company.

Trigger Event	Frequency
To reverse losses or potential losses	5
New opportunity to expand	5
Restore focus to the business	4
Arrival of new MD	3
Looking to raise finance	3
Outside pressure	3
Arrival/appointment of new team	2
Business just established	1
Looking for new partner	1
Sample size	**27**

Table 3 Distribution of the types of events that triggered a strategy review

Focus and having clear priorities were the major goals cited by management for doing the work, in addition to formulating a plan.

However the findings in table 3 need to be contrasted with the fact that all the companies foresaw spectacular growth over their next three years, irrespective of their past problems. The average three year growth figure was 108%, or roughly 35% per year. Indeed only one company thought that sales would decline. Not only did they foresee sales growing but they also believed that they could seize market share. Even with the three most extreme figures removed (usually the result of starting from a very low base), the average projected increase in market share was 23%. Only one company projected a loss of market share and just three believed that their share would remain the same.

In every case, the SMEs were found not to be homogeneous businesses. Rather they were collections of businesses. In that sense, the hierarchy of strategies suggested for large companies, is found to be repeated within the SME. However the difference is that the SMEs were unaware of it, in many cases. In that sense the first stage of the methodology is about developing an overall corporate strategy as well as revealing the identity of the embedded strategic business units (SBUs). The subsequent stages that concentrate on the SBU level are equivalent to developing a company level strategy.

Table 4 shows the number of SBUs per company. It can be seen that there is no company with only a single SBU i.e., that is a homogeneous business. In fact the most frequently occurring number is four SBUs per company followed by six. Seven companies identified four individual businesses within their company, albeit usually with a degree of overlap between them. Moreover there seems to be little correlation between the size of the company and the number of SBUs. Thus in the case of companies comprising four business units, annual turnovers ranged from £ 400,000 to £ 24 million.

Number of SBUs identified by the management team	Frequency
1	0
2	2
3	1
4	7
5	4
6	5
7	1
8	4
Greater than 8	2
Sample size	**26** – no record for one company

Table 4 Frequency of the recorded number of SBUs in a company

The methodology embedded within the tool requires the teams to specify if their operations are product or market orientated. There was no clear trend here with 53% saying they were driven by the market with the balance being driven by the products they sell.

The final piece of analysis to come out of the exercise, is a measure of the current performance of the SBUs. As the methodology is about how well the company's own plans meet the market requirements, a measure of congruence between the two has been developed. This measure is constructed by looking first at the factors the company believes to be critical to its success. Then the success factors that are relevant to its preferred way of marketing its products are identified. These are derived from the market model selected by the team. The degree of overlap is calculated by dividing the number of success factors that the two sources have in common, by the total number and expressing the result as a percentage. If there is entire coincidence between the two, the value will be 100%. Equally no overlap scores 0%.

The findings are shown in table 5.

% overlap between market success factors and those identified by the company	Frequency
0 – 20 %	0
21 – 40 %	4
41 – 60 %	9
61 – 80 %	8
81 – 100 %	2
Sample size	**23** –calculation not possible in other companies

Table 5 Degree of congruence between market requirements and the company's own plans

It is clear from the table that the majority of companies lie between 40% and 80%.

5. Conclusions

Three tentative conclusions can be drawn from these findings. The first is that SMEs are likely only to undertake formal planning when faced with some major change or crisis. Of course this comment must be taken with some caution. The companies recorded here are only those that asked for outside help. Others may well be developing their strategies in-house in a more structured way. However there is some anecdotal evidence to suggest that such a sanguine view is, at best, only partially true. For example, one company involved with the exercise had recruited a manager with considerable skill and experience of strategy formulation, albeit in a large organisation. The management still decided to involve an outside agency to carry out the task when it was prompted to plan ahead by an opportunity to expand.

A second conclusion is that SMEs seem little different from larger corporations when it comes to the diversity of businesses they are in. The major distinction is that they are often unaware of the fact. Even where they are aware they still run the operation as if it were homogeneous. Indeed there were cases where the company decided to split into divisions as a result of the exercise.

A third conclusion is that SMEs do not fully understand the markets they are in. This is reflected by their optimism, sometimes in the face of facts, about how quickly they can grow the business and about the amount of market they can grab from competitors. Another symptom of poor understanding comes from the discrepancies between their plans and what the market requires. Thus the danger is that the plans they do make are unrealistic.

Of course these findings may be equally true for large companies. What is clear from anecdotal evidence is that the SMEs embarked on the exercise because they found it hard to do internally through time constraints and, often, lack of knowledge. Larger companies often have the resources to carry out the work from within and are thus less impacted by these constraints. As a result they will be more aware of the issues highlighted above. Indeed, to take one example, structuring and restructuring of SBUs, is a common feature in large corporations.

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