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STRATEGIC PLANNING AND SMEs

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Abstract

Do small enterprises need strategic planning? What should be the horizon of such a plan, given the high mortality rate of new ventures often postulated in the literature?

A small business is not necessarily a little big business, so the elaborate corporate strategic planning process may not be strictly applicable to small enterprises. Consequently, within the constraints of their "smallness" what approaches to strategic planning can entrepreneurs use that will represent a middle ground of planning paralysis and no planning at all?

This paper critically evaluates the importance and benefits of strategic planning to SMEs. It suggests that if planning is tailored to the appropriate stage of development of a typical small enterprise, then the few that may evolve as they grow could be developed into a strategic plan that provides direction for future growth.

Introduction: The Value of a Strategy

Many owners and managers of businesses routinely plan their personal day-to-day operations, but do not believe that strategic planning applies to them. "Mention strategic planning, and they think of elaborate, bound documents resting on bookshelves in the offices of large companies, or of detailed plans used in project management" (Sandberg, Robinson, and Pearce, 2001:13). That is the fallacy. No business is too small to require sound strategy, and few strategies are so simple that they need not be developed into a strategic plan.

According to Robinson and Pearce (2003), a strategy spells out three elements that are essential to any business:

1. Goals it intends to accomplish

2. The policies or rules that guide its decisions, and
3. The actions intended to accomplish its goals.

A firm's strategy should serve as its logic for competing – a coherent encapsulation of its products and services, the markets and types of customers it serves, and the benefits it derives. From this logic comes the firm's decisions on how to position itself against rivals, which markets to focus, and which opportunities to pursue.

A strategy should also summarise the firm's logic for organising – an identification of key activities and how they will be carried out to realise the logic for competing. From the logic for organizing comes decisions on which activities are critical to the firm's success; how the tasks required by these activities should be grouped into jobs; and what criteria are appropriate in evaluating the performance of those jobs. Tight integration of the logics of competing and for organizing lays the foundation for the firm's competitive advantage – the basis of its superiority over rivals in serving a particular market or market segments.

Thurston (1983) argues that executives in smaller businesses can take various approaches to planning, ranging from informal and unwritten to the formal and written. The best approach depends on variables such as:

- Administrative style
- Officers' abilities, and
- Business complexities

To plan effectively, business executives must assess company strengths and weaknesses, business and personal objectives, and implementation approaches. Any formal approach to planning involves certain risks including emphasis on process. The most prevalent variable influencing the outcome of formal planning is how well the planning is done. "How well" is not the same as "How much." Companies with modest planning effort seem to benefit, provided that the effort is sound. The relevance of planning to a

particular company situation, not the degree of formality, is the key (Thurston, 1983).

Planning for Small Businesses

Waddel (1988) posits that routinely embedded in formal planning systems are four principles that are the minimum requirements for planning in small business.

The first principle is obtaining information about the industry, markets, and competitors. Conditions change, new competition emerges, technology advances, and markets shift. To survive, the small businessperson has to be flexible. Knowing what to change, how to change, and when to reposition products in the market come from scanning the business environment.

Second principle is that information simmered with reflection leads to strategy. The strategy that all businesses seek – and this is doubly important for small firms – is one that provides a sustainable competitive edge, such as price, quality, design features, service, or some combination. The third principle is that the strategy must focus the company on executing its competitive edge. Focus begins with how the company wants to be seen by its customers, its image in other words. Owners of successful small businesses are definite about their image. The final principle for successful small companies is that there must be budget for sales, expenses, and capital expenditures. A good budget is a financial representation of strategy and plans.

Waddel advises that these four principles can be followed without a formal planning process. Yet having timely, relevant information, creating the opportunity for reflection, focusing on a competitive edge, and putting meaning into a budget are just as essential for a small business, as they are for any big corporation (Waddel, 1988).

In a research to find out whether there was a relationship between planning and performance in small firms, Rue and Ibrahim (1998), concluded that the literature strongly supports the argument that planning is a key issue. Planning increases the success rate and it also affects the level of performance.

Even though, there is not yet an established theory on the actual differences regarding performance between formalized and non-formalized planning for SMEs, the researchers found out that firms with structured planning procedures outperform firms with non-structured planning procedures. In addition, they concluded that formal planning results in a wider variety of strategic decision-making. They also found that structured planning processes are more thorough and are associated with improved performance as measured by growth of sales (Rue and Ibrahim, 1998).

Planning Satisfaction in Small Firms

Steiner (1979) provides a thorough conceptualization of strategic planning. According to Steiner, planning is an attitude and a process concerned with the future consequences of current decisions. Formal strategic planning links short, intermediate, and long-range plans. Strategic planning does not attempt to make future decisions, even forecast future events. It need not replace managerial intuition and judgment with massive, detailed set of plans.

Langley (1988) also provided support for the benefits of SME planning by identifying four roles of formal strategic planning:

- Public relations role
- Information role
- Group therapy role
- Direction and control role

In the public relations role, formal strategic planning is intended to impress or influence outsiders. The information role provides input for management decisions. The group therapy role is intended to increase organizational commitment through involvement of people at all levels of the organization in strategic planning. Finally, the direction and control role is fulfilled when plans serve to guide future decisions and activities toward consistent ends.

According to Roach and Allen cited in Kargar and

Parnell (1996), the strategic planning process is the product of best minds inside and outside the corporation. The process considers future implications of current decisions, adjusts plans to emerging business environments, manages the business analytically, and links, directs, and controls complex enterprises through practical, working management system.

There are three frequently cited reasons why top managers pursue changes in strategy (Parnell, 1994). First, a change in strategy may appear attractive if the desired performance levels are not being attained by the organization. In many cases, top managers may believe that a change in strategy will improve the ability of the business to generate revenues or profits, increase market share and/or improve return on assets or investment. Many studies have concluded that declining profitability is the most common catalyst for strategic change (Webb and Dawson, 1991).

Second, an environmental shift may necessitate strategic change to maintain alignment. Such shifts may result from changes in either the macro environment (for example, new regulations, social forces, demographic changes etc.) or the industry environment (for example, new competitors, changes in competitor strategies, etc.). Changes in competition and technology necessitate a change in the knowledge base within the organization if it is to survive. According to the population ecology perspective, the environment determines which organizations will survive and which ones will not. New firms better suited to the changing environment constantly replace existing ones. Competitors constantly struggle for existence by seeking to procure additional resources. As such, strategic change can be seen as a means to access additional resources and survive in a turbulent environment (Kargar and Parnell, 1996).

Third, strategic change can enhance effective resource utilization. Barney (1991), a proponent of the resource-based perspective, has noted that competitive advantage often occurs from such organizational attributes as informational asymmetries, culture, resource accumulation, and minimisation of transaction costs. Hence, as organisational, human, and capital resources

evolve, changes in strategy become necessary to fully utilize the resources available to the organization.

Resource shifts necessitating strategic change are more prevalent in some organizations than in others. Organizational performance, age, and length of tenure of the founding entrepreneur influence the degree to which a funding strategy endures and thus, the prospects of strategic change (Boeker, 1989).

Benefits and Costs of Strategic Change

There are three potential benefits of strategic change that are commonly cited in the literature. First, strategic change can enhance the strategy-environment fit. For example, Calingo (1989) found that low cost leadership strategy is most successful in price sensitive markets, whereas the product or service differentiation strategy is most successful when consumers perceive great differences among product offerings.

Second, strategic change can open up new dimensions of competitive advantage untapped by competitors. These first mover advantages result from the willingness of an organization to enter a new market or develop a new product or service prior to competition (Kargar and Parnell, 1996).

Finally, the strategic change can improve an organization's ability to adapt by forcing healthy changes within the business. The initial pain associated with change may be offset by the emergence of a lean, rejuvenated organization with fresh focus on its goals and objectives, limiting the creativity and potential contributions of its members.

Regardless of the potential benefits, Kargar and Parnell (1996) posit that four potential costs may be incurred as a result of a strategic change. First, strategic change increases perceived risks; a change in any key strategic environmental, or organizational factors requires that the business develops a new formula for success suited to the change. Second, change can disrupt the strategy-culture alignment. Although the organizational culture may be changed to reflect and support the

change in strategy, the period of time required to do so is likely to take several years. Thirdly, measures required to implement a change in strategy may necessitate outlays of capital. Finally, strategic change may result in consumer confusion as they begin to alter their perceptions of the organization's products and services.

Even when strategic change results in a successful new product or service, there is no assurance that this success can be maintained. Indeed, competitors may distort consumer perception and reap the benefits of the initial strategic change. For example, many consumer goods companies implement an "imitation strategy." As a result, many consumers purchase the imitation product thinking it is the original. If the consumer dislikes the product, this dissatisfaction can be transferred to the original product. If the consumer likes the product, the consumer may realize that the product is an imitator and transfer the positive association to the original product. Either scenario can prove costly to the originator (Kargar and Parnell, 1996).

The relationship between planning and performance in small firms bears significantly on strategic management research and practice. The planning literature appears to suggest two key themes: First, planning should be an integral part of the strategic management process. The benefits of planning can outweigh the costs. Most critically, one's competitors will likely enjoy the benefits of planning. Therefore, to ignore planning is to relegate a source of competitive advantage to disadvantage.

The second theme is perhaps most critical. Effective planning, not just planning, appears to be positively associated with organisational performance. In other words, organizations that plan effectively are more likely to achieve higher performance than those that do not. The key here is effective planning. Ineffective planning appears to have no predictable or consistent association with performance. Going through the motions of planning provides no great insights or benefits; it may actually result in a depletion of resources and lower quality decisions. Thus, a strong emphasis placed on planning is only justified when it is focused on effective planning.

Small-Scale Planning

Strategic planning is a dynamic process. It implies change but change need not translate into expensive programmes. A useful distinction can be made between first - order and second-order changes. According to Moyer (1982), a small-scale planner, using operating plans to improve present operations, is effecting first-order change. The firm is simply doing better what it did before. Strategic planning, however, implies second-order change. Strategic planning for the firm's future is one of the most exciting business concepts in practice today. It is normally an ongoing detailed formulation of plans showing how well-defined objectives can be accomplished. This process requires a constant time commitment that often causes small business managers to defer this activity, given the pressures of the day-to-day business (Kirk and Noonan, 1982).

However, Shuman and Seeger (1986) would argue that strategic planning techniques used to guide the affairs of large businesses are not appropriate for smaller businesses. They advised that many such techniques cannot be used in smaller businesses at all because of the differences in scale of operations; few appear to account fully for the limited resources (including time) of the typical small business. None explicitly includes the personal characteristics of the important people in the business so that the strategy reflects their strengths and weaknesses and satisfies their personal needs and objectives.

In a classic Harvard Business Review article titled "A Small Business is not a Little Big Business," Welsh and White (1981) observed that a traditional assumption among managers had been that small businesses should use essentially the same management principles as businesses, only on a smaller scale. Underlying that assumption has been the notion that small companies are much like big business but with lower sales, smaller asset base, and fewer employees. Welsh and White argue that the very size of small businesses creates a special condition, which they refer to as "resource poverty". This distinguishes them from their larger counterparts and requires quite very different management approaches.

According to the authors, resource poverty results because of various conditions unique to smaller companies. For one thing, small businesses tend to be clustered in highly fragmented industries – wholesaling, retailing, services – that have a lot of competition which are prone to price-cutting as a way to build revenues.

A good plan is not enough in itself to save a firm, but it can increase the chances for survival. Small firms that display a higher level of formal planning tend to show higher performance in terms of growth rates. However, as Welsh and White (1981) have noted above, "small businesses are not little big businesses." According to Kirk and Noonan (1982), the ability to understand and deal with their limitations and to capitalize on their advantages is the essence of strategic management.

Some Basic Limitations

A look at some of the limitations affecting small business can be helpful to the strategist. Failure to understand these limitations will lead to a plan that cannot be executed.

Financial resources are the foundation of any strategic plan. Kirk and Noonan (1982) identify four sources of funds for smaller firms: debt, equity, depreciation, and net profit after tax. The inability of small business to tap a balanced mix of these sources leads to the condition Welsh and White call "resource poverty." Debt is an essential source of funds for small business. Most available debt financing tends to be short-term. Outside of the owner's personal wealth, and that of relatives, friends and other associates, there is no general equity market for small businesses. Small businesses generally tend to have a small fixed-investment base; thus depreciation is not normally a significant source of funds. Net profit after tax is the source upon which small businesses must rely for a large part of their funds. Consequently, every effort should be made to maximise profits.

Extreme sensitivity to an internal cash flow imbalance is a constant problem for small business strategic planners. Internally, funds are generated by net profits after tax and by depreciation, and consumed by periodic increases in working capital

and capital investment. Thus, as a business grows, it commits more funds automatically to receivables, to inventories, and to such other areas as plant and equipment. This relationship can be more clearly expressed as follows:

- $\text{Internal Cash Flow} = \text{Net Profits After Tax (Z)} + \text{Depreciations (D)} - \text{Changes in Working Capital (W)} - \text{Changes in Capital Investment (I)}$

It is easy to see that if net changes in W and I exceed Z and D, outside financing in the form of debt or equity must be secured to continue operations. Given that (1) a large percentage of businesses consume cash that they generate; (2) a new product on the average has negative cash flow for about five years; and (3) external sources for funds are extremely limited, small businesses are subject to a never-ending cash flow crisis.

In addition, small businesses tend to have limited product and service lines targeted for specific groups or geographic locations. The decline of one or two products may produce severe negative consequences.

Limited people resources also plague most small businesses. Entrepreneurs have that special ingredient that allows them at the outset to handle a variety of functions. But, in time, other human resources become necessary, and the inability to draw from a large, trained pool of talent can be devastating.

Good market information is usually scarce. Information is the cornerstone of effective strategic planning. Small firms have little organized data collection on markets and competitors; information on these subjects is usually either unavailable or unreliable.

Finally, friends who provide capital may be a burden. They frequently tend to take a personal interest in the business. Such assistance is seldom constructive but is often destructive.

Some Basic Advantages

Having gained an understanding of small business limitations, the small business strategic planner should concentrate next on the advantages.

Some of the basic advantages of SME strategic planning include:

Flexibility: Flexibility is one of the most essential of these advantages. The Strategic Window concept states that "there are only limited periods during which the fit between the key requirements of a market and the particular competencies of a firm competing in that market are at an optimum." Small businesses have the ability to move first, while their counterparts in big business sometimes are bogged down with a bureaucracy of red tape and a painfully slow decision-making process. They do a little analysis and thereafter take a plunge because by the time an opportunity is investigated fully, it may no longer exist (Bhide, 1994).

Customer Focus: Business opportunities exist for those who can produce products and services desired by customers. If a business can make its products or service especially attractive, its prospects will brighten considerably. Good customer service can be provided by a business of any size. However, small firms have a greater potential than larger businesses for achieving this goal. If properly managed, entrepreneurial firms can serve customers without struggling through layers of bureaucracy or circumventing corporate policies that tend to stifle staff initiative. In many cases, customers are personally acquainted with the entrepreneur and other key people in the small business (Longenecker et al, 2000). These small businesses tend to be in close touch with their communities and customers. They can do more individualized jobs than big firms can. They thereby attract customers on the basis of speed, specialty products, quality, and personal service rather than solely on the basis of price. "While competitive prices and reputation for honesty are important, an atmosphere of friendliness makes people feel good about patronizing SME businesses and makes them loyal customers" (Megginson et al, 2003:14).

Integrity and Responsibility: The future is particularly bright for firms that add excellent product quality and good customer service to a solid reputation for honesty and dependability. Customers respond to evidence of integrity because they are aware of ethical issues. Experience has taught them that advertising claims are sometimes not accurate, and that businesses sometimes fail to stand behind their work or claims. If a small business is consistently ethical in its relationships, it can earn the loyalty of a skeptical consuming public.

Comprehensive Learning Experience: A small business provides employees with a variety of learning experiences not open to individuals holding more specialized jobs in larger companies. Along with performing a grater variety of functions, small business employees also have more freedom to make decisions, which can lend zest and interest to their work experience. As a result, small businesses train people to become better leaders and managers and to develop their talents and energies more effectively (Megginson et al, 2003).

Stage Of Development and Strategic Planning

A firm's stage of development has long been postulated as a contingency factor of major importance for strategic planning. "The most fundamental variable in determining an appropriate business strategy is the stage of the product life cycle" (Hoffer, 1975). Research, therefore suggests that the effectiveness of a firm's strategic process is contingent on its stage of development. Cooper, cited in Robinson and Pearce (1984), offers a simple typology of the stages of development through which small firms progress:

1. The "start-up" stage, including the decision to found a firm and position it within a particular industry using a particular competitive strategy.
2. The "early-growth" stage, when the initial product-market strategy is being tested. The owner/manager tends to maintain direct contact with all major activities, and stabilization of the firm's sales pattern often

occurs.

3. The "later-growth" stage, often characterized by multiple sites for retail and service businesses and by some diversification for manufacturing firms.

Studies of strategic planning behavior in small firms suggest that small firms do not engage in systematic planning. According to Pearce and Robinson (1984), in order to address these perceived shortcomings in small business planning, a prescriptive literature evolved that emphasized the importance of "outsiders" as valuable and often necessary assistants to owner/managers in fulfilling their planning responsibilities. Among such outsiders are consultants, lawyers, accountants, bankers, and board of directors, whose time and expertise help to compensate for the lack of the same on the part of the owner/manager, thus, making a more effective planning effort possible. In a major study, Robinson (1982) found significant improvement in profitability, sales growth, employment, and productivity for firms engaging in "outsider-based" strategic planning. Robinson and Pearce concluded that outsiders are important to SMEs for several reasons:

- They compensate for lack of full-time planning staffs of the SME;
- They improve the quality of decision-making and the likelihood of continued, systematic planning; and
- They make up for lack of formal planning skills of the owner/manager.

The authors argue that improvement in effectiveness obtained by small firms that engage in strategic planning is not contingent on the stage of development. The stage of development, they reiterate, may play a contingency role in terms of strategic planning intensity, but not in terms of the process.

At Stage One, strategic planning is principally directed at enabling the firm to improve its ability

to gain a foothold in the marketplace (sales growth). Thus, this stage appears to be a trade off between sales growth and profitability in stage one. At Stage Two, strategic planning concentrates on the firm's growth (sales and organizational size) as it seeks to become an established viable competitor. After growth is achieved, strategic planning in Stage Three SMEs emphasise growth, stabilization, and profit improvements to insure the firm's long-term viability and markets (Pearce and Robinson, 1984). ■

Conclusion

In conclusion, the rules of competitive game of business have changed dramatically. To be successful, small businesses can no longer do things the way they have always done them. Fortunately, successful small business owners have at their disposal a powerful arsenal to cope with the ever-increasing uncertain environment: the process of strategic planning.

The goal of developing a strategic plan by the SME, therefore, is to create for the small company a competitive advantage: the aggregation of factors that sets the small business apart from its competitors and gives it a propitious position in the market. From a strategic perspective, the key to business success is to develop a unique competitive advantage, one that creates value for customers and is difficult for competitors to successfully imitate.

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*The ultimate measure of a man
is not where he stands in moments of comfort and convenience,
but where he stands at times of challenge and controversy.
- Martin Luther King, Jr.*