

## 10.2 Small business survival in competitive markets

In 2007, when it was about to launch into America, Tesco had a 31 per cent share of the UK grocery market and a position that an analyst referred to as 'scale-proof against competition'. In other words Tesco was thought to be untouchable in the UK market because its market share gave it so many economic advantages over rivals: buying cheaper because of bigger bulk, able to secure the best locations and so on. As we know, it didn't work out that way. By 2015, market share was slipping back to 28 per cent.

What this proves is an important point: the benefits of scale are often overrated. Size matters, but it's often better to be small and nimble than big and slow. And it's important to remember that 'small' is an entirely relative term. The UK grocery market is worth about £180 billion a year. So a 1 per cent market share means sales revenue of £1,800 million a year. Iceland, with a 2 per cent market share, usually manages annual profits of £150–200 million a year.

Nevertheless, it's reasonable to suggest that small firms have to be alert, efficient and nimble to survive. A large business such as Mars can live on past glories (such as Maltesers, born 1937) but a small firm may have to reinvent itself regularly in order to keep up with changing tastes and sharp competition.

## 10.3 Reasons to stay small

### Product differentiation and USPs

Maintaining a level of product differentiation can be key to the success of small businesses. It enables them to avoid direct competition from mass market providers. However, differentiation may stifle growth because it limits the product to a small niche. A company that specialises in manufacturing gluten-free food should have limited sales because only 3 per cent of the population needs to avoid gluten. If the business uses 'free from gluten' as its point of differentiation or even uniqueness, its market will remain small, thus limiting growth. Expansion would rely on moving away from the very point of differentiation that created success – a decision that may be considered too dangerous by directors.



Figure 10.2 Gluten free is a niche market

### Flexibility in responding to customer needs

**'Many leaders of small firms focus on making their business work efficiently and on delivering high-quality customer service. There is absolutely nothing wrong with these objectives. They are both essential aims. However, if they lead to rigidity and the exclusion of variation then they can undermine the key advantage that small businesses have over large businesses – agility.'**

*Paul Sloane, leadership speaker on innovation*

If firms are to maintain their popularity with consumers, it is vital that they adapt to changes in the marketplace. The easiest way to discover what consumers want is to monitor their behaviour in-store – shop-floor staff can provide invaluable feedback on changes in customer behaviour and tastes. The problem of growing too large is that organisational structures develop too many layers between shop-floor staff and senior decision-makers. These layers of middle management have an insulating effect, with middle managers often seeing their role as filtering the information their staff provide to prevent their bosses being overloaded. Of course, this filtering



Figure 10.3 Logic chain: successful flexible response

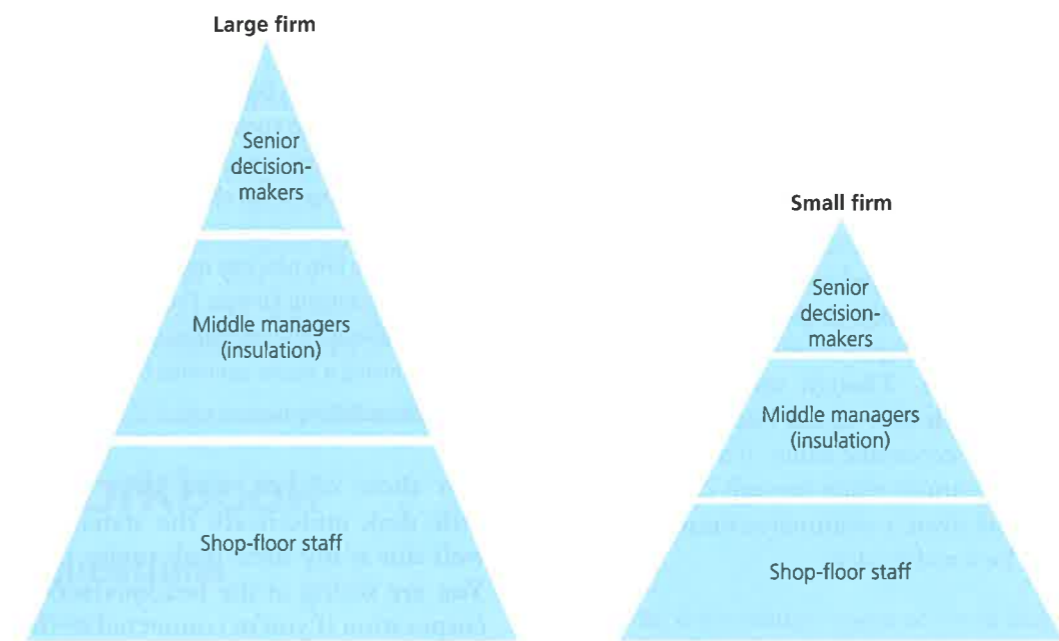


Figure 10.4 Small firms have fewer management layers between the top and bottom of the structure

can prevent vital insights reaching key decision-makers within the business. A firm that chooses to stay small may do so to ensure that there are fewer structural layers between shop-floor staff and senior managers.

### Customer service

**'Because I didn't have much money, I bought a small shop to fit my budget. The previous six owners had closed their business in three years. The store had no people traffic and, because of that, I was able to focus on figuring out how to provide a better service to each and every one of the customers that did come through.'**

*Do Won Chang, Founder of Forever 21*

Delivering excellent customer service needs staff who care about how they treat customers. This is easier to achieve when the contribution that each member of staff makes to the business is clear to them. Motivation theorists, notably Professor Herzberg, suggest that if the results of your work are easily identified, greater motivation and therefore better performance is likely to result. If a single employee can make a difference to the overall performance of a business they will work hard, rewarded by clear recognition of a job well done. Those who work for large companies may feel their own performance makes little difference to the business's success. For a business that is heavily reliant on great

### Real business

Renowned for the level of product knowledge offered by owner and former cricketer Paul Cook, Cook and Matthews is a single sports shop, specialising in top-end cricket equipment. Started in 2009, the shop has built a strong reputation among keen amateur sportspeople as the place to go for impartial advice. The main problem that the business faces in expansion is that it has only one Paul Cook – i.e. the owner is the trusted source of advice for customers and he can only be in one place at a time. Despite initially planning to open more than one branch, at present Paul is more than happy to keep the business small and build its reputation.

customer service, staying small can help to ensure that all staff deliver this.

### e-commerce

Electronically generated commerce (e-commerce) occurs when commercial transactions take place online. This could be as simple as buying a book on Amazon or as complex as putting through a purchase for a complex, one-off production-line robot, ordered from Japan. In 2015, the average UK adult ordered more than £1,000 of goods online, creating an e-commerce market size in excess of £50 billion. Although more than 15 per cent of people's spending is now online, the scope for further



growth seems huge. A lot of that growth will come from 'm-commerce', that is, making purchase while on the move, using a smartphone or tablet device. Mobile ordering is already becoming dominant at Domino's Pizza and Just Eat.

In 2012, a 15-month-old company with 13 employees was bought for \$1 billion by Facebook. The company was Instagram and there proved to be instant riches for the 13 staff, who shared \$100 million between them. This story shows that in a digital world a 'small business' can be worth a fortune. Though small in terms of staffing, the global reach of a digital business gives rise to virtually unlimited economic value. If a small firm is so specialised that it cannot reach enough customers in its local area to break even, e-commerce means that the business may still be a viable idea.

### Real business

888 Reptiles, based in Daventry, was set up in 2003 by a team of reptile fans to supply snakes, lizards, other reptiles and all the equipment needed to keep reptiles as pets. With such a specialist market to satisfy, the firm needed to service a wider market than just local customers. Using its website to take orders, the firm now has regular customers all over the UK as well as in mainland Europe. Though still small, the company has a large enough market thanks to the use of e-commerce to continue running a viable specialist business.

(Source: [www.888reptiles.co.uk](http://www.888reptiles.co.uk))

'For those of you who have as an office a little desk underneath the stairs, and you say, well this is my little desk under the stairs, no! You are sitting at the headquarters of a global corporation if you're connected to the Internet. What's happened is, we've changed the scale. Size and scale are no longer the same.'

Eddie Obeng, *British organisational theorist, educator and author*

## Five whys and a how

Questions	Answers
Why do small firms react faster to change?	With fewer layers of structure for messages to pass through, messages get through more quickly, allowing senior managers to find out about market changes faster and implement their own changes faster.
Why are staff more likely to be motivated in small firms?	People who can easily see the impact on the business of their own contribution should see their working life as more 'meaningful', which Herzberg says is crucial to motivation.
Why can a USP limit growth?	If the unique feature of a firm's product appeals only to a tiny target market, then, assuming the firm continues to maintain its USP, growth will be limited by the size of that niche.
Why might some owners choose to avoid growth for personal rather than business reasons?	Growth is likely to bring an increased workload and less control over their work-life balance – something which may run contrary to their reasons for setting up the business.
Why may e-commerce raise a business's costs if customers pay for deliveries?	The cost of designing and then regularly updating and maintaining a website is significant, whilst more staff time is required to process orders and arrange for delivery.
How can small firms reach a global audience?	The use of e-commerce means that even a small, home-based business that sets up a website is able to show up on searches carried out anywhere in the world.

## 10.4 Reasons to stay small – evaluation

Some firms choose to stay small, whilst others, by their nature, will always find it very hard to grow beyond a certain size. The choice of staying small will often boil down to the personal objectives of the business's

owner(s). For those that started their business to give themselves a better work/life balance than they could find in employment, the extra workload that comes from growth will be unattractive. Other businesses stay small because key aspects of the business simply cannot be expanded, perhaps due to a very unusual USP that appeals to only a tiny niche market, or because the

business is totally reliant on the entrepreneur interacting directly with each customer.

The idea of staying small can often be frowned upon – there is a widely held belief that 'business success' depends, at least in part, on growing the business so it gets bigger and bigger. However, history is littered with examples of businesses that have failed due to their pursuit of growth, such as The Royal Bank of Scotland, or because their huge size made change hard to achieve in the face of a changing external environment – such as Nokia and

Kodak. Sometimes, small can be great – bringing benefits of agility, flexibility and innovation. Indeed, the rise of concepts such as intrapreneurship suggest that even large firms understand there are benefits to be gained from harnessing the power of small-scale operations.

### Key term

**M-commerce:** electronic transactions carried out while on the move, such as ordering an Asda delivery by smartphone.

## 10.5 Workbook

### Revision questions

(30 marks; 30 minutes)

- 1 Explain two possible problems arising from growing as a business. (6)
- 2 Explain why customer service may be better in a small local garage than at a national chain such as Kwik Fit. (4)
- 3 As an organisation takes on more staff, explain briefly two possible impacts of this growth on the shape of its organisational structure. (6)
- 4 Explain two possible consequences for a small business of starting to sell via a website. (6)
- 5 Assess two possible impacts of opening three new outlets on a small cafe which is differentiated by the friendliness and customer service of its proprietor. (8)

### Revision activities

#### Data response 1

Morris Ltd and VH Engineering plc are both manufacturers of components used in UK car factories. Although both were founded in the 1980s, Morris Ltd has remained small, in contrast with VH Engineering plc which has pursued a strategy of rapid growth over the past 20 years.

Shareholders at VH Engineering plc are concerned that the company has developed a reputation of being slow to respond to market change. Although sales remain high, analysts attribute this to the firm's willingness to cut prices on its products which tend to offer fewer features than those of market-leading businesses.

	Morris Ltd	VH Engineering plc
Employees	50	1,200
Total revenue (£m)	35	850
Marketing budget (£m)	0.5	15
Levels of hierarchy	3	8
Average manufacturing cost per unit (£s)	25	31.5
Product reject rate per 1,000	2	6
Operating profit	5	114

Table 10.2 Data for Morris Ltd and VH Engineering plc

#### Questions (40 marks; 45 minutes)

- 1 Calculate the operating profit margin for both firms. (4)
- 2 Assess two possible reasons why cost per unit may be lower at Morris Ltd. (8)
- 3 Assess two possible reasons why Morris Ltd is faster at responding flexibly to changing customer needs. (8)
- 4 Evaluate the possible consequences of VH Engineering plc responding slowly to market change. (20)



## Data response 2

Hussein Hickmet's rise to fame was remarkable. Within just two years of graduating from one of London's top design schools, his fashionable menswear had featured three times on the front cover of men's style bible GQ magazine. With a small but elite group of customers, featuring many premier league footballers, other sports stars and Hollywood celebs, Hussein's business was hugely profitable. His advisors recommended that he reinvest the profits in order to allow the business to grow, developing a far wider range of designs that could be distributed through high-street fashion retailers. The pressure to grow was immense, with his wealthy customers also offering to invest extra capital into the business. Hussein, on the other hand, preferred to

remain small. Industry analysts were left to speculate on the reasons for this decision as Hussein himself refused to talk to the press. He continues to produce designs that remain popular with his small, hardcore group of extremely loyal, and wealthy, customers.

### Questions (35 marks; 40 minutes)

- 1 State three common objectives for business start-ups. (3)
- 2 Assess the possible problems Hussein may have faced if he had chosen to widen his product range and distribute through major high-street retailers. (12)
- 3 Evaluate the possible reasons why Hussein refused to grow his business. (20)

## Extended writing

- 1 'Most established small businesses remain small because they cannot grow rather than actively deciding to avoid growth.' Evaluate this statement. (20)
- 2 'Sports car manufacturer McLaren sell such a highly differentiated product, it will always remain a small business in the context of the total global car market.' Evaluate this argument. (20)

## Section 3.3 Decision-making techniques

# 11 Quantitative sales forecasting

### Definition

Quantitative sales forecasting involves estimating possible future sales figures on the basis of available primary or secondary quantitative data.

Linked to: Sales forecasting, AS Ch 33; Impact of external influences, Ch 5; Investment appraisal, Ch 12; Decision trees, Ch 13; Scenario planning, Ch 24

## 11.1 Introduction

It is very important for managers to look ahead. They need to think about what is likely to happen in their industry and prepare accordingly in all areas of the business. One of the most important forecasts that needs to be made is the **sales forecast**. This forms the basis of most of the other plans within the organisation. For example:

- The human resource plan will need to be based on the expected level of sales; a growth in sales may require more staff.
- The cash flow forecast will depend on projected sales and the payment period.
- The profit and loss forecasts will depend on the level of revenue predicted.
- Production scheduling will depend on what level of sales is expected.

The sales forecast therefore drives many of the other plans within a business and is an essential element of effective management planning.

When a business starts up, it is extremely difficult to interpret its sales data. An ice cream parlour that starts up in April may find that sales double in May, again in June and again in July. Excited by the business success, the entrepreneurs may rush to open a second outlet. Yet a wet August may see sales knocked back, followed by a sales slump in the autumn. The business may be overstretched and in liquidation by February.



Figure 11.1 An ice cream parlour needs to take seasonal sales variations in to account

As long as a business can survive the first year or two, managers can start to interpret its sales data. Above all else, managers want to understand the **trend** in product sales and compare it to trends in the market as a whole.

There are three main methods used to provide a quantitative sales forecast:

- moving averages
- extrapolation
- correlation

Each is dealt with below.

'Good forecasting requires an understanding of your buyer's behaviour.'

Scott Edinger, *Forbes magazine*

'If you have to forecast, forecast often.'

Edgar Fiedler, *economist*

## 11.2 Moving averages

A useful way to show trends is by using a moving average. This is helpful in two main circumstances:

- 1 where there are strong seasonal influences on sales, such as in the ice cream parlour example