Case Studies of Small Business Success: Exploration of a Four Factor Success Model

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Abstract

This paper examines the findings of a longitudinal study of small business performance among owner-managers in Australia. Following an initial survey conducted with 55 firms a factor and discriminant analysis of the results identified 4 factors significantly associated with growth in sales revenues over a four-year period. These factors included: 1) ***Key data awareness*** *– identifying and collecting key data to measure the satisfaction of customers with products or services; 2)* ***not price driven*** *– not competing on price and having customers who would remain loyal if faced with price rises; 3)* ***business generating system*** *– clearly identifying market opportunities, selling into an established market with proven products or services, developing new markets and creating a systematic approach to creating new customers, and 4)* ***use of experts*** *– a willingness to use expert advisors to assist growth. This paper describes this four-factor model of small business success and illustrates the merits of the model by reference to case studies drawn from the original sample. Managerial and research implications of the model are provided.*

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"Distinctive Competencies" for Business Growth

Successful growth within any business is the product of a complex mix of variables that are both internal and external to the firm. Such variables are frequently related to "enterprise resources" which include all assets, skills, capabilities, organizational processes, attributes, information or knowledge under the enterprise's control, that can be used to develop competitive positional strategies (Daft, 1983; Barney, 1991).

Not all enterprise resources will be valuable to the development of competitive advantage (Barney, 1986). Those resources that do offer competitive advantage are referred to as *distinctive competencies* (Lado, Boyd and Wright, 1992). Selznick (1957) first described an enterprise's distinctive competencies with specific reference to managerial qualities. A variety of authors have examined the concept throughout the past three decades (Ansoff, 1965; 1976; Learned, Christensen, Andrews and Guth, 1969; Hofer and Schendel, 1978). Empirical examinations of the concept (Snow and Hrebiniak, 1980; Hitt and Ireland, 1985) generally conclude that the source of distinctive competencies are internal rather than external environments, and derive from the way an enterprise uses its resources relative to its competition (Reed and DeFillippi, 1990). Further, they can be applicable to both large and small enterprises (Stoner, 1987).

Successful growth within the small business is dependent upon the capacity of the owner to manage expansion within the limits of their resources. The 'distinctive competencies' or 'base potential for development' found within the firm include the financial, physical and human resources as well as the experience, leadership, ideas and control base of the entrepreneur (Gibb and Davies, 1992). Key resource issues facing the growing small firm are a lack of technical and managerial skill, inadequate organisational adaptability and ability to acquire or use technology (Jones, 1992).

As the business growth cycle continues the owner must learn to transfer their own expertise and knowledge to their staff in order to free themselves for further developmental work ‘on' rather than ‘in’ their business. This requires the small business to shift from being ‘culture-based’ around the personality of the owner, to a ‘systems-based’ structure that can successfully reproduce and maintain itself without the presence of the original owner.

Models of Successful Small Business Growth

Interest in the growth of small business has traditionally taken second place to study of the growth cycles of much larger firms. However, since the 1960s several theoretical models of small firm growth have been proposed (Barnes and Hershon, 1976; Steinmetz, 1969; Churchill and Lewis, 1983; Scott and Bruce, 1987).

Few empirically tested models of small business growth occur within the literature. A study of 220 “INC 500” small firms in the United States found a strong relationship between planning and successful growth (Shuman and Seeger, 1986). In another survey of “INC. 500” high growth firms Baker, Addams and Davis (1993) found a strong relationship between regular strategic planning, written business plans and growth. Such firms for internal controls rather than to assist with securing external funding used formal plans. Further, the strategic planning undertaken by such firms was found to be positively associated with profitability.

In an examination of 364 small business case studies over a ten-year period Dodge and Robbins (1992) found that internal issues posed greater problems for growing small firms than external environmental issues. A four-stage model comprising formation, early growth, later growth and stability were postulated. Most owners found planning a major on-going challenge. Customer contact, market feasibility assessments plus location and expansion of these markets were the key marketing problems.

A study by Pelham (1997) of 160 small industrial firms found a significant relationship between market orientation and ‘firm effectiveness’ – as measured by new product development, customer retention and relative product quality. These mediating variables influenced the firms' performance in terms of sales growth, market share and profitability. Such findings are consistent with those relating to larger firms as measured by the Profit Impact of Market Strategy (PIMS) database (Buzzell and Gale, 1987; Bharadwaj and Menon (1993).

Within the field of small business globalization several models have been proposed to explain the successful export development strategies of small firms. Cooper and Kleinschmidt (1984) proposed an export growth model involving export performance as a function of firm or management characteristics; export marketing policies and market or industry characteristics. A later study of 640 small and medium manufacturing firms found a relationship between successful export growth and such factors as – a high export orientation, regular product customization or adaptation to customer requirements and a willingness to seek outside expert assistance (Donthu and Kim, 1993).

Moini (1995) in a further study of 102 small exporting firms in the United States developed a model suggesting that successful export growth was related to firm characteristics – size, products, resources – rather than the characteristics of the owners – age, education levels, language skills.

Hall (1992) proposed a model of small business performance drawing upon a small sample of 30 high-growth UK-based small to medium enterprises. This qualitative study identified six key dimensions of small business performance:

1) **Focus/Direction** – This dimension relates to fashioning and managing the overall focus and direction of the business. Successful businesses are thought to have a clear focus and direction, which allows them to harness their personal energies and add value to the business.
2) **Customerising** – The focus here is upon continually delighting the customer. The process of customerising focuses resources on to customer contact on an ongoing basis.

3) **Partnering** – This dimension requires 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.
4) **Personality -** The character of the business is usually linked to that of its owner. Personality is the perceived character of the business, both internally and externally. Internally, personality creates common commitment to the vision. Externally, it provides and image to your customers.
5) **Quality** - A commitment to providing product quality and customer service is deemed essential to business success. A commitment to providing product quality and customer service is important to developing high quality. It involves having ASA/ISO standards as well as strong 'customer delight'.
6) **Systems** – Finally, establishing systems to provide information to empower decision-makers is an important element. Control systems are essential to any business. Some are more effective than others are. Formal and informal systems are required to assist in decision-making.

Methodology

In 1997 a study was commenced with the purpose of testing the validity of the original model developed by Hall (1992) using empirical analysis. A questionnaire was developed which measured the perceptions of small business owner-managers as to their current performance on the six dimensions identified in the Hall (1992) 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.

Sampling

An original sampling frame of 500 firms was identified and approached over their willingness to participate in the study. Their commitment required completion of an initial survey followed by subsequent involvement in a national panel. A total of 88 owner-managers agreed to participate and a final usable sample of 55 surveys was returned. This provided a response rate of 62.5 per cent.

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 less than 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, 1998). The final sample of 55 firms – while small – can be described as representative of the small business sector.

Factor Analysis and Results

An exploratory factor analysis was undertaken on the 180 question items in the survey. Separate analyses were undertaken within the six key dimensions using a principal component extraction method. In keeping with this approach all factors extracted required eigenvalues greater than one and all were tested with measures of sampling adequacy (MSA) prior to factoring (Kaiser, 1974). Further, the factor loading for those factors selected for subsequent analysis were in excess of 0.4, which is generally considered a reliable benchmark for significance (Hair, *et. al.* 1995:239). Factor solutions that produced scale reliability statistics – Cronbach (1951) alpha scores – greater than 0.5 were accepted. The 180 question items in the survey yielded several factors grouping each of the six original dimensions identified by Hall (1992). Table 1 shows these results.

Table 1: Factors Produced from Six Original Dimensions

Dimensions	*Factors*	*MSA scores*	*Factor loading*	*alpha scores*
Focus/Direction	**Six** – Mission, Vision, Environmental scanning, Resource security & Human resources	0.58-0.83	0.61-0.90	0.71-0.93
Customerising	**Five** – Developing customer commitment, Networking, Problem seeking/Problem solving, Customer Delight & Market Development	0.59-0.84	0.44-0.99	0.69-0.85
Partnering	**Nine -** Partnership focused, Structure = strategy, Customer loyalty, Customer focused, Staff loyalty, Supplier focused, Suppliers = strategy, Has support network & Use of experts & family.	0.55-0.65	0.46-0.90	0.51-0.92
Personality	**Five** – Owner personality, Staff personality, Values leadership, Values planning & Image.	0.70-0.78	0.48-0.90	0.58-0.86
Quality	**Seven** – Defining Quality, ASA/ISO 9000, Customer focus, Innovation, Changing beliefs and attitudes, Price driven & Value added.	0.65-0.84	0.49-0.93	0.67-0.90
Systems	**Seven** – Key data use, Key data awareness, Information systems, Financial awareness, Key indicators, Action oriented & Action culture.	0.69-0.88	0.59-0.92	0.70-0.89

Measurement of Business Growth

The survey measured business growth by four years of gross sales revenues. These figures ranged from -$120,000 to $473,200. They were converted into an index of annual sales growth that divided the sample into to sub-populations – those with annual sales growth of less than $320,000 over the four-year period and those with sales growth in excess of this.

This provided a broad division of the sample into high and low growth firms with respect to their sales growth. A total of 19 firms were classified as ‘High’ growth and 19 as ‘Low’ growth using this index. The remaining firms were excluded from further analysis due to incomplete or missing data.

Discriminant analysis

The original U.K. study had derived these dimensions from qualitative analysis of a sample of firms already identified as high growth (Hall, 1992). To examine whether a statistical relationship existed between these six general dimensions and the dependent variable of annual sales growth a discriminant analysis procedure was used. This procedure determines the linear combination of predictor variables that best classifies cases into one of several known groups.

Preliminary analysis of the six general dimensions originally identified by Hall (1992) found a significant relationship between “**Partnering**” and the growth measure (Mazzarol, 1998). However, in order to fully explore the relationship between the growth measure and the 40 factors identified in the factor analysis a further discriminant analysis procedure was undertaken using a stepwise approach. Of the original 55 firms in the sample 33 were used in this procedure, the remainder being excluded due to missing or out of range group codes.

One discriminant function that differentiated the high and low sales growth firms was found to be significant at the 0.05 level after four steps. Four of the 40 factors measuring the six broader dimensions of business performance were found to be significant at 0.05 levels. Table 2 shows these results.

Table 2: Final Variables in the Discriminant Analysis - Factors

Standardised canonical discriminant function coefficients

Factor Variable	*Function 1*	*Wilk's Lambda*	*Significance*
Key data awareness	.74	0.732	0.0021
Not price driven	- .73	0.625	0.0009
Business generating system	.58	0.540	0.0004
Use experts & family	.57	0.464	0.0002

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 0.05 levels. A total of 74 per cent of the low growth firms and 74 per cent of the high growth firms were correctly classified. An overall 74 per cent of firms were correctly classified in the model. Table 3 shows these results.

Table 3: Classification results from discriminant analysis - Factors

		Predicted membership	
Actual group	*Cases*	*Low sales growth*	*High sales growth*
Low sales growth	19	14 (73.7%)	5 (26.3%)
High sales growth	19	5 (66.7%)	14 (73.7%)

Percentage of grouped cases correctly classified: 73.7%

Discussion of findings

These findings provide a more comprehensive picture of the possible relationship between management activity and annual growth in sales within the sample. The four factors identified in the discriminant analysis as being significant are drawn from four of the six dimensions:

- **Key data awareness** – is drawn from the **Systems** dimension and is comprised of two variables. The first relates to the owner having clearly identified the critical information needed by them in order that they continually exceed their customer expectations. The second concerns whether or not the owner has examined how he or she gets business and identified what information they require.
- **Not price driven** – is drawn from the **Quality** dimension. It is comprised of two variables. The first relates to whether or not an increase in the firm's prices will affect demand for its product. The second is whether price is considered to be a real factor in determining customer-buying decisions.
- **Business generating system** – is drawn from the **Customerising** dimension. This consists of four variables. The first is concerned with the owner's focus on growing their business by selling proven products or services to more customers. The second relates to the firm's capacity to plan for and allocate sufficient resources to the development of new markets. The third involves the owner's view that long term prospects in their primary markets are excellent. Finally the last variable is whether or not the firm has an effective business-generating system in place to create new customers.
- **Use experts and family** – is drawn from the **Partnering** dimension. It consists of two variables. The first is related to the owner's awareness of and ability to access grants and expertise available to assist their business. The second is a more personal one and concerns the owner's ability to make space to spend time with family and friends.

Case Studies

In order to investigate this model of business performance a series of case studies were conducted with members of the original panel of 55 respondents. The purpose of these cases was to examine first hand the relationships that appeared to be found in the data analysis. The application of each business to all six dimensions was examined and the sample was divided into the high and low performing firms. In the following sub-sections two case studies are provided. These examples illustrate the relationship between the four key success factors and market performance.

Case Study 1 - Small Manufacturer

This small manufacturer had experienced substantial growth over the previous three years, expanding its employment base from six to 120 employees (including casual labour). The firm had also commenced a nation-wide expansion moving its operations interstate from coast to coast. Its product – an industrial building component – was sold to a small number of large customers usually involving three-year contracts.

In terms of '**key data awareness'** the firm's owner made it clear that his company spent a substantial amount of time monitoring the activities of both his customers and competitors. His main competitor was a large international company with lower cost structures. Faced with such competition the owner targeted six potential new customers. He spent time finding out what their requirements were and then narrowed his field down to three who seemed to be favoring his firm over the competition. By focusing on the needs of these three rather than the whole six he was able to secure three good contracts and left the rest of the field to the competitors. Constant environmental scanning by the owner was deemed crucial to avoiding being 'wrong footed' by the larger competitors.

In terms of **pricing** the firm had commenced charging a premium price approximately 5 per cent over the mean in the industry. The owner did not consider that his company made 'super profits' but he **did not compete on price** for contracts and sought to make a better than average profit margin within his industry. Over the previous three years he had commenced raising his prices and considered there was room to charge more.

The owner identified customer service as an important aspect of his **‘business generating system’**. He described customer service as ‘one of the key planks in the company’. The owner indicated that he was still responsible for most of the selling. He stressed the role of innovation in winning new business. Customers sought a value add and by carefully monitoring customer needs. According to the owner he attempted to place himself into the customer’s situation and think of what he can offer them that is new or innovative. By doing this he was able to go to them and offer a solution to a problem. This had paid substantial dividends as he explained:

> “We had a case recently where one of our competitors offered our biggest client much better prices than ours. The customer told me this in his office. He had a big desk and he said all the papers on his desk represented problems that he was trying to solve, **but not one** of these problems related to my company so there wasn’t any need to change. So that is the kind of thing that happens when you’re willing to work hard on customer service”.

In addition to servicing the needs of its existing customers the company was also allocating resources to the development of new products and new markets. The owner explained how he was seeking to empower his employees to assume greater levels of responsibility so that he could free himself to become more strategic. The move interstate was absorbing more of his time and he needed to establish entirely new business operations in these cities. He had to plan for this carefully to ensure that his existing operations did not falter. Team building within his company was now a key focus.

The company also demonstrated its willingness to **use experts and family** to assist the business. According to the owner his wife was a major participant in the business. She joined him in sorting out various problems as they arose and he relied upon her to help him. Equally important was the relationship he had developed with his bank. He described spending two years developing a close working relationship with his banker. This was critical to his operations as the business had cyclical cash flows with sales four times larger during the summer months than at other times of the year. However, the company had to gear up during the winter to fill its inventory so as to meet the summer orders. The bank had greatly expanded his overdraft facility enabling the company to meet its short-term debts and wages bills during the winter. This **partnering** with the bank was now a key element in the firm's success.

Case Study 2 - Small Service Firm

This small firm was engaged in high quality post-production work for TV Commercials, documentaries and film work. In recent years it had begun to expand into multimedia and web site design. The company had grown strongly in recent years commencing with three staff and now employed thirteen. This comprised audio and video editors and graphics specialists. Its customer base was small but consisted of about 100 to 200 key clients. Over the previous three years the company had invested substantially in new equipment and production facilities.

According to the owner it was difficult to monitor **key indicators** as the environment – both internal and external – changed so rapidly. He expressed concern over the need to keep aware of such information and described how the company had originally performed around 90 per cent of its work for the corporate sector and had now reduced this to 15 per cent. The firm sought to monitor its customer satisfaction levels and had a well-defined customer service policy. These customer service levels had not been formally addressed within the company in its early years and the owner was seeking to do so. He had now introduced a formal system of monitoring customer satisfaction and held 'mini-seminars' for his staff using graphs to illustrate customer service performance.

In addition to monitoring the existing customers the owner described how he was now monitoring the **external environmental change** now taking place within his industry. It was noted that some of his customers were beginning to establish 'in-house' facilities to do the work he had performed. Some of these customers were likely to become competitors over time. He was therefore looking for new markets and seeking to

generate new business. The company was beginning to look overseas for opportunities and had set a 12-month horizon to achieve certain goals.

The company did attempt to 'delight its customers' although this was not easy within their industry as 'advertising people are quite fickle'. As the owner explained:

> "We try and handle their wants, like 'I want' as opposed to 'I need'. We give better customer service than the average, like a car yard or whatever. We hope to please constantly. They are always quick to find fault."

The owner was monitoring his financial information on a weekly basis and monitored his break-even points with this. In terms of **price competition** it was difficult within his industry to always charge a premium price on all jobs. However, the owner indicated that his main aim was 'to work smarter not harder' and this meant seeking those jobs that offered the better margins. His only suppliers were videotape manufacturers and therefore it was staff time that the company was essentially selling.

The owner also indicated that he was willing to **use experts, family and friends** to assist his business. He had a strong personal relationship with his accountant and worked with a business mentor to assist his business development. In addition to this professional advice the owner drew support from his circle of business friends and colleagues to discuss things relating to his business.

Managerial and Research Implications

These two case studies are typical of several similar cases that demonstrate a link between the four-factor model shown in Figure 1 and business growth.

The four significant factors associated with the growth index measure used in the study highlight additional issues that the small business owner needs to address. They suggest that small business owner-managers seeking growth will need to gather **'key data'** on how they attract their customers and seek to monitor the level of satisfaction they deliver to these customers. The development of a **'business generating system'** will be important. This will require a focus on identifying long-term market opportunities and selling proven products or services into these markets. Attention will also need to be given to planning for new market developments that will require allocation of resources to achieve this.

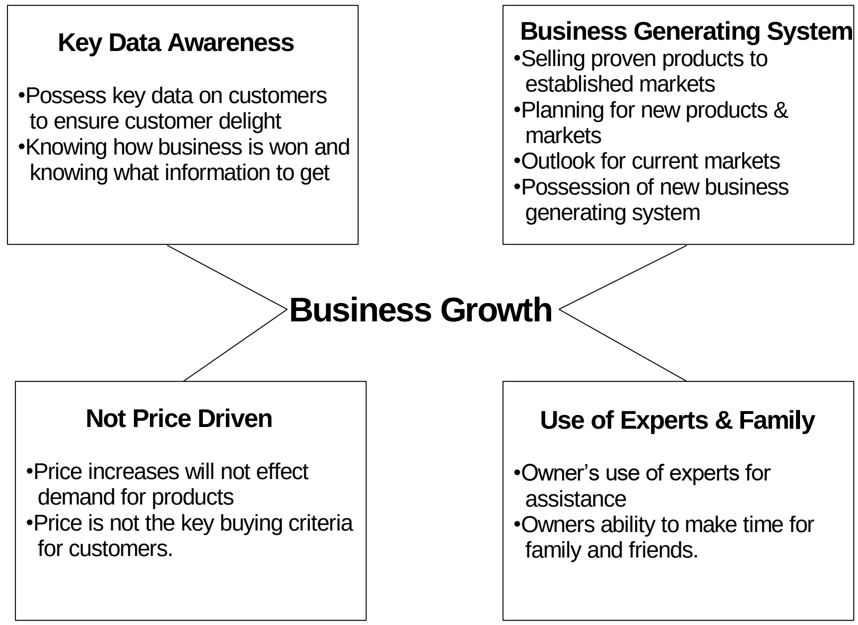

Figure 1: Four-Factor Model of Small Business Growth

In successfully developing any market the small business owner-manager should avoid competition purely on price. Avoiding being **'price driven'** will require **value adding** to products or services to enable customers to buy for reasons other than price and justify any **premium prices** charged.

Finally, the findings suggest that success growth can be assisted by **use of experts and family**. The owner-manager who can access expertise and other forms of support – e.g. grants – will widen their base of skills, ideas or resources. This is a **Partnering** focus that should contribute to the small business growth process. Incorporated into this appears to be the need for the owner to consider **holistic life planning**, whereby they include time for family and friends in their activities. Given the important association that often exists between family and business life for many small business owners, this would seem a logical consideration.

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. Future research into this model is planned using a larger sample. If the results can be replicated it can provide a useful framework for guiding small business growth.

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