

Entrepreneurship and Small Business Management

Chapter Two **Small Business Management**

CHAPTER TWO

SMALL BUSINESS MANAGEMENT

2.1 Definition of Small Business

The small business (cottage industry) may be defined as an enterprise or series of operations carried out only by a workman skilled in the craft on his own responsibility, the finished products of which he markets himself.

Small business is a business which is independently owned and operated, not dominated in its field of operation and meets certain standard of number of employee and capital.

Generally, there are two approaches to define small business enterprises: Size criteria and Economic/control criteria

1. Size criteria

- ❖ **Sales volume** – Amount of product an enterprise produce and sell in specified period of time(usually one year)
- ❖ **Number of employees**
- ❖ **Asset size**
- ❖ **Volume of deposit**
- ❖ **Insurance in force**

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2. Economic/control criteria

- ◆ Market share
- ◆ Independence
- ◆ Management style

The most widely used criteria to define small business are number of **employees** and amount of **capital**. Accordingly, the following definition is determined to be applicable by the Ministry of Trade and Industry in Ethiopia;

- Micro enterprises are business enterprises found in all sectors of the Ethiopian economy with a paid-up capital of not more than Birr 20,000 and less than 20 employees, but excluding high-tech consultancy firms and other high-tech establishments.
- Small Enterprises are business enterprises with a paid-up capital of more than Birr 20,000 and not exceeding Birr 500,000 and with number of employees ranging from 20 – 100, but excluding high-tech consultancy firms and other high-tech establishments.

2.2 Characteristics of Small Business

1. Actively managed by its owner - independent Management
2. No or few management layers
3. Style of management is highly personalized. I.e. the owner has firsthand knowledge of every move in the business at all levels and he is the main decision maker
4. Relatively small in size within the industry as compared to the highest unit in its field
5. Largely dependent on the internal resources of capital to finance its growth.
6. Capital is supplied by ownership and is held by an individual or a small group
7. Limited resources: a small business is unlikely to have sufficient resources to dominate the market.
8. Independence: the owner has ultimate authority and effective control
9. Scope of operations: small enterprises serve a limited segment of local or regional market
10. Scale of operation: they occupy a limited share of given market.
11. Labor: they are low in capital and high in labor, as they cannot afford capital-intensive machinery.

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12. Specialized skills: The small enterprises normally have **specialized skills** for **certain specific clients** & does well in small, and isolated market
13. Small business does well in developing markets as it can easily absorb the changes
14. Small business survives well in a bad business condition due to having quick and clever capability of bringing changes in cost and labor.

2.3 Major Areas of Small Business

Small business tends to do better in some industries than in other:

1. **Service business**- requires a small capital investment to get started. E.g., hotels and transportation services.
2. **Retail business**- buying products from whole sellers and reselling the products to final consumer
3. **Wholesale business**-buying products from large manufacturers and reselling the products to retailers
4. **Manufacturing business**
5. **Agriculture**

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2.4 The Importance of Small Business Enterprises

- a. Greater value in building up a local production structure and in promoting economic growth
- b. As a means of creating **employment** opportunity, and achieving a fair distribution of nation resources, income, knowledge and power
- c. A seed bed for development of local entrepreneurship
- d. Promote rural industrialization
- e. More appropriate technology is applied
- f. Supplier of parts and accessories to bigger industries
- g. Play prominent role in promoting the export market

2.5 Environment of Small Business

- ☐ **Internal Environment**
- ☐ **External Environment**

2.6 Factors that contribute to the success of small business

- Hard work, drive and dedication
- Market demand for products/ services provided
- Management competence

2.7 Common Causes for Small Business Failure

- Managerial incompetence or inexperience-
- Neglect
- Weak control system
- Under capitalization: too few funds to survive start up and growth
- Failure to clearly define and understand your market, your customers, and your customers' buying habits
- Poor financial control
- Over investment in fixed asset
- Failure to plan current as well as future operation
- Failure to adopt proper inventory control system
- Improper Attitude (The entrepreneur may not respect time, employees and may have lazy lifestyle and dictatorial style of work)

- Inadequate marketing plan
- Incorrect market identification
- Poor distribution channel
- Poor location
- Weak marketing communication or promotion

2.8 Problems in Ethiopia Small Business

- ☐ Scarcity of capital.
- ☐ Limited and unequal access to institutional credit markets.
- ☐ Irregular access to domestic and imported inputs coupled with higher cost.
- ☐ Inadequate infrastructure facilities.
- ☐ Weak managerial and technical skills.

2.9 Setting Small Business

2.9.1 Business Ideas

A business idea is some one's opinion regarding what may or may not be a good business. There are three types of business ideas. They are:

- ✚ ***Old idea*** – Here an individual copies an existing business idea from someone.
- ✚ ***Old Idea with Modification*** – In this case the person accepts an old idea from someone and then modifies it in some way to fit a potential customer's demand.
- ✚ ***A new Idea*** – This one involves the invention of something new for the first time

Sources of Business Ideas

- ✓ Customers
- ✓ Existing companies
- ✓ Distribution channels
- ✓ Research and Development units
- ✓ Government

Reading assignment

2.9.1 Small Scale Industry & Large Scale Industry

Definition

There are three parameters that are generally accepted, either signally or in combination, in defining the terms in most countries, these are

- ☐ Number of workers employed which is the most widely used criteria
- ☐ The level of capital investments or assets
- ☐ The volume of production or business turnover.

In many countries, medium scale industry is not defined and is understood to include those that fall between small and large industries

Accordingly, Small scale industry means an industry that has less capital and employee less workforces and Large-scale industries refers to those which have relatively substantial capital and greater annual sales turn over.

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Advantages Associated With Small Scale Industries

- Production of consumer commodities.
- Labor intensive approach for commodity production there by scaling down the extent of unemployment as well as poverty.
- Efficient and equitable distribution of national income
- Promotes balanced development of industries across all the regions of the economy.
- Development of skills required for entrepreneurship
- Act as an essential medium for the efficient utilization of the skills as well as resources available locally.

Advantages of Large Scale Industries

- (1) Economies in making the goods, and
- (2) Economies in marketing the goods.

1. Economies of large scale production saves in;

-  Capital cost per unit of product
-  Labor cost
-  Possibility of making improvements
-  Cost of superintendence (the act of managing/supervising/overseeing sth.)
-  Utilization of waste
-  Providing their own aids to making and marketing their own cans, boxes, etc., and owning railways and steamship lines, etc.

2. Economies in marketing of goods;

-  Economy in **securing trade**, through advertising and commercial travelers
-  Economy in "**carrying " stocks of goods**", a relatively smaller stock being sufficient to meet the fluctuations in demand
-  **Economy in getting goods to consumers**, through the power to secure better freight rates for large shipments, and through the power possessed by some concerns to avoid "cross freights"
-  Economy in **securing a foreign market**, through the greater power of the large concern to withstand the cutthroat competition common in "hard times."

2.9.2 The Start up Process of a Small Enterprise

Starting a new business requires the following steps:

STEP 1: Identification of New Venture Opportunities

STEP 2: Evaluation & selection of New Venture Opportunities

STEP 3: Technical, Marketing & Financial Feasibility of the Project

STEP 4: Assessment of Personal Requirements & Org. Capabilities

STEP 5: Analysis of Competition

STEP 6: Developing Action Plans

STEP 7: Implementation and Evaluation

STEP 1: Identification of New Venture Opportunities:

In the search for new ventures, entrepreneurs explore both **external** and **internal** sources.

The external sources include:-

1. Newspapers, trade journals, professional journals etc. which tell about trends in fashions, customs and other social areas.
2. Professional magazines catering to particular interests such as electronics, computers, and oils etc.
3. Trade fairs and/or exhibitions displaying new products and services.
4. Government agencies.
5. Ideas put forth by others.

Internal sources basically consist of storehouse of knowledge build up by an individual over the years. An entrepreneur draws upon it and undertakes the following exercise:-

- a) Analysis of concepts in the light of existing problems and their capacity to solve them.
- b) Search of memories to find similarities and elements related to the concept and its problems.
- c) Recombining the elements found in new and useful ways.

Sources of Ideas for New Products

- Necessity: identification of potential customer needs & tailoring the product and services to meet them.
- Hobbies/ Personal Interest
- Watching Trends in Fashions and Customs
- Observing other's Deficiencies; eg. Devt of a key that will identify a person
- Gap Filling
- Novel Use of Known Products; new uses of existing products etc,...

STEP 2: Evaluation & selection of New Venture Opportunities

While evaluating the major points to be considered are:

- ❑ ***Technical feasibility*** that is the possibility of production with the available skill & technology
- ❑ ***Commercial viability*** of the idea based on cost and profitability. It evaluates the tradeoff between cost and income to judge the attractiveness of a business idea

Pitfalls in Selecting New Venture Opportunities

- 1) ***Lack of objectivity:*** Some entrepreneurs get so obsessed with their idea that they overlook the need to scrutinize its feasibility. No wonder such projects end up as failures.
- 2) ***Market Myopia:*** A shortsighted approach of concentrating on production rather than on marketability could lead to an avoidable disaster. An entrepreneur may fail to properly assess the market acceptability of his product. Selection of the right time for introducing the product is important for its success..
- 3) ***Inadequate Understanding of Technical Aspects:*** Technical difficulties involved in the production of a product are a time consuming and thorough job. ***Inexperience*** in this area can prove quite costly and swamp a budding enterprise.
- 4) ***Lack of Product Differentiation:*** To capture the market, the product should have distinctive characteristics in terms of design, utility and other features. Assured superior performance over the products is essential to provide it a competitive edge.
- 5) ***Overlooking Legal Issues:*** A smart entrepreneur should be alive to meeting the various legal requirements. For instance, workers should be provided with legitimate legal dues, consumers are provided with reliable and safe products, copyright, trade mark etc. should be observed.

STEP 3: Technical, Marketing and Financial Feasibility of the Identified Project

A. Technical Feasibility: covers the following

1. *Identification of critical technical specifications;*

- a) The functional design of the product.
- b) Adaptability to the new customer demand.
- c) Durability
- d) Reliability of performance
- e) Safety
- f) Reasonable utility (i.e. acceptable level of obsolescence)
- g) Standardization (i.e. elimination of unnecessary variety)

2. *Examination of product quality-cost relationship:*

- Understanding that there are **tradeoffs b/n technical excellence & associated cost** i.e. a positive relationship exists between technical quality and costs.

3. *Product testing, which includes:*

- a) Engineering studies relating to machines, tools, instruments work flow etc.
- b) Product development through blueprint, models, prototypes.
- c) Product testing through *laboratory testing* and *field-testing*

B. Market Feasibility

1. *Identifying the Market Potential*

- ✓ Specific end users,
- ✓ Major market segments, and
- ✓ Potential volume of purchases within each market segment.

2. *Estimating Cost-volume Relationship to ascertain how various price levels may affect total sales volume.* The price must reflect the value of the product. The entrepreneur may not adopt a uniform price structure to take care of the sensitivity of the buyer to price changes. The cost-volume analysis would also facilitate the determination of appropriate **economies of scales** i.e. optimum size of enterprise, which has lowest average per unit cost of production and distribution.

3. *Sources of Market Information:* Relevant data for market analysis can be gathered from two main sources viz (a) **primary** sources such as interviews, mailed questionnaire, survey etc and (b) **secondary** sources like government agencies, trade unions, chambers of commerce etc. Whereas the former is costly, the latter may not meet the requirements of the entrepreneur.

The following kind of data matrix may be quite helpful:

- ❖ Data relating to general economic trends as revealed by various indicators such as new orders, house activity, inventories consumer spending.
- ❖ Market data relating to demand pattern, seasonal variation etc.
- ❖ Pricing data i.e. range of prices for same, complementary and substitute products; base price; discount structure etc.
- ❖ Channels of distribution both wholesale and retail.
- ❖ Data relating to competitors.

To obtain this data, the entrepreneur may either conduct his own survey or approach a consultant.

4. Market Testing: It is an important method of **establishing the overall feasibility of a new venture**, significant market testing methods include:

- Displaying the product at trade fairs,
- Test marketing to analyze the receptivity of the product, and
- Sample sales.

C. Financial Feasibility

It covers the following:

- ❑ ***Determination of total financial requirements***
- ❑ ***Financial resources and other costs: financial resources could be categorized on the basis of periodicity into:***
 - ✓ ***Short term resources:*** (those payable in a **year**). Trade credit supplies, short term loans from banks or other lending institutions, sales of account receivable etc. belong to this category.
 - ✓ ***Intermediate term Loans:*** Intermediate term loans are those available for **one to three** (sometimes five) years. It includes terms loans from banks, lease finance, financial assistance from institutions etc.
 - ✓ ***Long-term loans*** are those from banks, equity capital and investments of earnings.
- ❑ ***Cash Flow Analysis***
 - Net Cash Flow = Cash inflow – Cash outflow***

STEP 4: Assessment of Personal Requirements & Organizational Capabilities

- A) Activity analysis; identifying the total range of activities and level of skills
- B) Grouping the activities into set of tasks that individuals can handle effectively.
- C) Categorization of various tasks to form the basis of structure of organization.
- D) Determination of interrelationship between different positions and designing of organizational hierarchy.

STEP 5: Analysis of Competition

Generally, every organization faces two types of competition:

- ❖ Direct competition from similar products.
- ❖ Indirect competition from substitutes.

STEP 6: Developing Action Plans

No strategic plan is complete until it is put in to action. To make the plan workable, the business owner should divide the plan into projects, carefully defining each one of the following:

- ✓ **Purpose:** What is the project designed to accomplish?
- ✓ **Scope:** Which areas of the company will be involved in the project?
- ✓ **Contribution:** How does the project relate to other projects & to the overall strategic plan?
- ✓ **Resource requirements:** What human & financial resources are needed to complete the project successfully?
- ✓ **Timing:** Which schedules & deadlines will ensure project completion?

STEP 7: Implementation and Evaluation

Now it is the time of **reality**. When action plans are materialized according to the action plan which is composed of various projects, business plans are considered to be implemented.

After implementation, evaluation follows. Evaluation is mainly concerned towards ensuring the achievement of mission, objectives etc.

2.9.3 Field Problems of Starting a New Enterprise

(1) Pre-operator problems

- Problem of selecting an appropriate form of business organization.
- Problems related with the acquisition of basic facilities such as sources of raw materials, power, transport etc.

(2) Problems during the construction phase.

- ❖ Acquisition of land;
- ❖ Construction of building and other aspect of civil works;
- ❖ Acquisition of machinery and its installation;
- ❖ Preliminary work about the sources of supply of raw materials , labor and managerial inputs;
- ❖ Prospecting about marketing;
- ❖ Preliminary work regarding sources of working capital;
- ❖ Coordination problem connected with the acquisition of different kinds of assets or completion of jobs;

(3) Post Operative Problems of a New Enterprise

□ Lack or absence of profits

□ Experience Factor:

- ✓ Unfamiliarity or lack of experience in product or services line.
- ✓ Lack of experience in *management*. There is a vast difference between being a machinist and being able to manage a machine shop.
- ✓ Over concentration of experience .e.g. .focusing only on the area of interest says, sales, finance, production etc and neglecting others.
- ✓ Incompetence of management.

□ Sale Causes

- Weak competitive position ;
- Lack of proper inventory control;
- Low sales volume ;
- Poor location ;
- Decline in demand due to recessionary trends in the particular industry ;
- Inappropriate marketing strategy ;
- High production costs and consequent high pricing ;

❑ **Expense Causes** i.e. failure to control operating expenses that reduce profit and Pose a threat to survival of the firm. For instance, borrowing too heavily may force business to close if debts cannot be timely paid;

■ **Neglect Causes:** Common Cases of neglect are; poor health, laziness, family or manage Problems. Entrepreneurs need to establish priorities for themselves relative To their involvement in the firm. They must concentrate on objectives of the Firm.

■ **Capital Causes**

- Low or over estimation of capital needs;
- Fund mismanagement ;
- Cash losses;
- Poor debt collection or unfavorable credit terms.

❑ **Customer Causes** .i.e. extension of credit on liberal terms.

❑ **Personnel Causes.**

- ✚ High rate of absenteeism &/or labor turnover
- ✚ Unhealthy industrial relations
- ✚ Frequent strikes and lockouts
- ✚ Low productivity
- ✚ Militant trade unions

❑ **Natural calamities** such as burglaries, earthquake .fire etc...

❑ **Government Regulations.**

- ✓ Difficulty of compliance due to excessive cost burden;
- ✓ Interference and dilatory tactics adopted by government authorities.

❑ **Unmindful expansion** so that sufficient business is not generated to sustain expanded capacity.

❑ **Environmental Causes**

- Changes in government policy ;
- Changes in social or political conditions ;
- Inflationary pressures leading to increases in the input cost.

❑ **Production Causes**

- ❖ Technological obsolescence;
- ❖ Low capacity utilization;
 - Inability of labor to correctly understand technology;
 - Non-availability of spares and replacements;
 - Poor machinery maintenance;



THANK YOU!!!