

# Introduction to Small Business

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## Lesson Aim

To introduce general business structures and principles for small operators.



Small businesses make up one of the most vital parts of any economy. They employ a large percentage of the workforce, provide most of the 'grass roots' services such as retailing, and represent a major sector of investment.

People decide to start up a small business for a variety of reasons, but all with the overall aim of achieving financial success. However, due to the large number of problems a small business may encounter, especially in its first few years of operation, many do not survive.

Owning and operating a small business can be challenging, rewarding, and stimulating as well as hard work. For those prepared to take the risks and who finally make it, the sense of achievement and satisfaction is well worth the effort. Most businesses start small, as an idea, interest, hobby, or part time job, etc. Some are successful, flourish, and grow to become the full-time employment of the founder. Many, however, fail!

Success or failure in small business usually is tied to one major ingredient: the ability of the owners to manage the intricacies of an enterprise. Most small business people come to the challenge of beginning and running a small business with skills, interests, and specialities in their chosen field. However, their expertise and interest is often limited. Successful business people must develop competence in all aspects of the business.

Competencies include:

- Product or Service Design
- Purchasing
- Marketing
- Selling
- Servicing
- Administration and Planning
- Accounting
- Self-Management
- Selling
- Financial Management

Businesses are enterprises that exist for the purpose of providing goods or services to consumers with the aim of making a profit. There are many definitions of what constitutes a small business. One of the most commonly accepted descriptions is: *"Small businesses are enterprises where all major decisions are the responsibility of one, two or a few people who are usually the owners or proprietors."*

Generally, the people who are successful in business are those who kept trying different things until they finally found something that worked. The successful small businessperson is almost certainly an enthusiastic sort of person who enjoys hard work and a challenge.

There are various types of businesses you might consider:

### **Services or goods-based**

Service-based businesses provide the customer with a service (e.g. repairman, designer, babysitter).

Goods-based businesses provide the customer with a tangible product (e.g. tools, equipment, materials, food, books).

### **Small or large**

Do you aim to operate a small or large business? Large should NOT be the obvious answer! Larger businesses do not necessarily make more profit than smaller ones in the same field.

Larger businesses can be more difficult and expensive to manage, and are often more risky, particularly if you lack experience (it may be preferable to control your growth and not let your business get too big too quickly).

### **SMALL BUSINESS SECTORS AND STRUCTURES**

Businesses can be divided into three sectors depending on the nature of their major activities.

The **primary** sector includes businesses that are involved in gathering natural resources so that they may be used in manufacturing or food industries. Primary industry businesses include those involved in mining, farming, grazing, fisheries and forestry.

The **secondary** sector involves businesses changing those natural resources and adding value to them by some form of processing or manufacturing. This sector would include businesses involved in metal fabrication, plastic manufacture, food processing, fuel and metal refinement, craft industries or book production.

The **tertiary** sector involves enterprises that provide services. This would include wholesaling, retailing, health services, communications, design services and many of the trades such as plumbing.

No matter the economy, the importance of small businesses should never be underestimated. Small businesses usually provide the goods and services that large businesses do not. They provide the local, personalised and specialist output that larger businesses often find unpractical – because of their size of operations.

Basically, small businesses make up approximately 95 percent of all businesses, employ around 41 percent of all non-government workers, and contribute about 25 percent of the Gross Domestic Product each year.

### **TYPES OF BUSINESSES**

There are thousands of different types of businesses in the world, and almost as many different ways of classifying them. Generally, one way is as good as another, the main advantage being that looking at some system of classifying businesses can help you gain a better overall appreciation of the business world.

Businesses are concerned with the exchange (or trading) of goods and services. Money is used as a convenient measure of giving relative value to goods and services in this exchange process. Value of goods and services are affected by many different things including:

- Scarcity (i.e. supply. Is it easy to get or not?)
- Demand (how much do other organisations or individuals want a particular good or service?)
- Quality (is a particular product or service better than others which are available?)

Supply and demand are interrelated factors:

- When something is in good supply, the demand (and often the cost) can decrease.
- When something is in poor supply, the demand (and often cost) can increase.

### **WAYS TO VIEW BUSINESSES**

There are various options to consider when entering any new business in terms of size, scope of operation, and market position.

### **Size of the Operation**

- Small
- Medium
- Large

(Judged on the annual turnover, the gross profit, the net profit, or perhaps the number of staff or capital invested).

### **Positioning Options in the Market Chain**

- Wholesale
- Retail

### **Type of Industry**

- Primary
- Secondary
- Tertiary

### **Product Options**

- Suppliers of goods (hard tangible products), or services (consultancy, maintenance of equipment, repairs, transport etc.)

### **Legal Structure Options**

- Sole Proprietorships/Sole Traders (owned by one person),
- Partnerships - (owned by several individuals),
- Companies - (a legal entity (in its own right), owned by shareholders)
- Joint ventures - (owned partly by different businesses – often a mixture of public sector and private sector).
- Companies can be private or public.

### **Degree of Specialisation**

- Specialised (selling a limited range of products or a limited range of services)
- Less specialised (dealing with a broader range).

Specialised businesses generally do better. There is a very big danger in trying to do too much and doing nothing really well.

Large businesses in the main market (with a few exceptions), tend to specialise within broad areas (e.g. a clothing retailer might expand to sell other types of products or might expand into other areas of the clothing industry such as manufacturing but it is rare that they would expand both ways). Diversification is a hedge against problems arising in the area you operate in, however, diversification should be limited within certain well-defined boundaries.

### **NATURE OF SMALL BUSINESS**

What is meant by 'small business'? 'Small' is a relative term and it begs the question: "Compared to what?"

While there is no universally accepted definition of a small business, a number of measurements can be used to determine whether a business is small, medium, or large.

The most common measurements are:

- Number of employees
- Asset value (the total worth of all assets owned by the business)
- Turnover (the volume of sales either in money terms or quantity over a set period of time)

These measurements are all based on some statistical calculation and expressed as a number. Because of this they are referred to as quantitative measurements.

Other definitions are based on qualitative descriptions, that is, the way in which the business is organised, owned, managed, and operated. It is based on personal observation and a description of the business.

A comprehensive definition of small business usually relies on a combination of both quantitative measurements and qualitative descriptions.

Studies have revealed that the average person uses the term 'small business' to refer to an owner-managed business that may employ a few people.

Small businesses are the main source of most inventions and innovations. An invention is the development of something new. Innovation occurs when something already established is improved upon. Many successful businesses are built on these two forces, especially on innovation. Research and development (R&D), however, can be rather costly. Small business faced with having to undertake R&D often find difficulty in obtaining adequate finance. Traditional sources of finance, especially banks, perceive this type of finance request as high risk. One possible source of finance for R&D is venture capital. Venture capital is money that is invested in small and sometimes struggling businesses that have the potential to become very successful. The investors take an equity position in the business (own part of it) and provide supplementary finance. When venture capital is used in the initial feasibility stage, that is, when determining whether a potential idea can lead to a profitable product and business, it is referred to as seed capital.

### **Success of Small Business**

All small business owners start off optimistically, believing that their business venture will lead to financial success and security. Many may have read some multitude of books available about being successful in small business. These books usually highlight five common 'keys' to small business success:

1. *Entrepreneurial abilities.* The people in small business are crucial to the success of the enterprise. Attitudes and personalities of owners will vary enormously. Some will have drive and enthusiasm, many will have set targets and some will take big risks. Some will thrive on the challenge of a potential failure, enjoying the process of solving problems. The majority will be highly motivated and optimistic.
2. *Access to information.* As a bare minimum, the small business operator must have information regarding profitability, the quality of products and services and the performance of employees. Accurate and up to date information will allow the small business owner to make the best decisions.
3. *Flexibility.* The small size of the business allows the owner to adapt quickly to changes in the external environment. Because there are fewer levels of management, decisions can be made quickly. In addition, the close contact between owners and customers allows the establishment of personal relationships, helping owners to respond quickly to their customer's changing tastes and preferences.
4. *Focus on market niche.* Small businesses can concentrate their efforts on a few key customers or a specific segment of the market. This provides the opportunity for the small business to become more specialised and able to deliver a high level of service.
5. *Reputation.* Because the small business is servicing a narrow market niche, it can develop enviable reputations for quality and service.

These five 'keys' above have been identified as major success factors. There are a number of other 'rules' for success in small business that can be followed:

- Create a build a business on a real market opportunity (in other words – find a niche).
- Identify or create some distinctive competence and convert this into a sustainable competitive advantage.
- Realise that the competitive advantage is only temporary. The business will either be extinct or different in five years. Planning ahead and searching for new opportunities must go on continually. *You must not be resistant to change.*
- Create and improve the business' image.
- Always strive to be the best – rather than the biggest.
- Remember that success comes from finding and/or creating opportunities.
- Build on strengths and concentrate effort and resources.
- Recognise the difference between efficiency and effectiveness.
- Be innovative.
- Seek and use expert advice.
- Recognise the various types of risks.
- Avoid being overly dependent on others.
- Believe in yourself and your business.
- Get rid of unprofitable and/or unsaleable products and services.
- Manage the business' resources efficiently and effectively
- Hire the right people, use them and involve them in the business, reward them wisely and identify the need to redeploy.
- Use time efficiently and effectively.
- Realise that every business/management decision and action will affect the business' survival ability.
- Watch for signs of mental stress and, if these are found, decide on the cause and deal with it.
- Be decisive and assertive – decide on the best course of action and follow it.
- Continually update product knowledge and technical skills.
- Regard cash flow as the lifeblood of the business.
- Keep good records.
- Regularly review the suitability of the business's location.
- Learn from errors made and do not repeat them.

### **Failure of Small Businesses**

In the real world, success can be hard to achieve. Sometimes enthusiasm and optimism can cloud the owner's vision of reality and poor decisions are made.

A small business has failed when it is:

- Unincorporated and declared bankrupt – a legal process of distributing among the creditors the property of the business or person who cannot or will not pay their debts.
- Incorporated and either forced into liquidation or voluntarily closes down because it cannot pay its debts and faces a cash flow problem.

If a business owner decides to cease operating because of ill health, the loss of a partner, or any other personal reason not associated with financial problems, then the business is not described as a failure!

Small business failure is not usually caused by one single factor but rather a combination of several factors. The two main reasons being:

- Lack of capital and
- Lack of management expertise.

Some of the many reasons small businesses fail are:

- Failed to plan
- Lack of information
- Leadership crisis
- Inaccurate record keeping
- Failed to delegate
- Complacency
- Failed to seek advice
- Incorrect marketing strategy
- Underinsured
- Poor location
- Lack of financial planning
- Negative cash flow
- New competitors
- Illness
- Supplier problems
- Not enough sales
- Poor use of external support services
- Economic downturn
- New taxes
- Changes in government policies
- Insufficient capital
- Partnership problems
- Lack of management experience
- Staff difficulties

- Incorrect pricing policy

*Remember: 'Small businesses don't plan to fail, they fail to plan!'*

### **SET TASK**

Conduct a search online or look in the classifieds advertisements in a Saturday or weekend newspaper (or in any other local listings), to see what types of businesses are for sale.

Are the prices asked what you would have expected?

Are there any particular trends which can be noticed? Look for:

- Types of businesses which seem to have a higher than expected sale price.
- Fields of business which appear to have a large number of businesses for sale at the moment.

### **PRACTICAL WORKSHEETS A, B and C.**

As you are working through Lessons 1 – 4, complete “Practical Worksheets A, B and C” from the online training system.

These worksheets aid to assess and identify your skills and weaknesses in the context of running a small business.

## Assignment 1

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### Question 1

What observations did you make while looking at businesses for sale in the newspaper or online?

Are there any particular businesses that appear to be more or less viable than others? Why, in your opinion? Write one paragraph.

### Question 2

'The word 'small' is a relative term. What does this statement mean? Write one paragraph.

### Question 3

What are the most common measurements used to determine whether a business is small, medium, or large? Write one paragraph.

### Question 4

What is the difference between quantitative and qualitative measurements? Which type of measurement do you think is more useful in assessing a business? Give reasons for your answer. Write up to half a page (250 words).

### Question 5

Write a paragraph outlining how a small business owner can maximise his or her chances of success by using the five 'keys' of business success.

### Question 6

From the checklist of rules for success in the lesson notes, select three that you think are the most important for success in small business. Briefly explain the three rules using a short paragraph for each.

#### Question 7

What exactly does 'business failure' mean? Why do you think so many small businesses fail in the first few years of operation? Write one paragraph.

#### Question 8

Write a brief outline of the work experience and training (education) you have had so far. What areas of your experience and training might increase or limit your potential for running your own business? i.e. your strengths and weaknesses. List these in bullet point form.

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