**CHAPTER TWO: SMALL BUSINESS: VITAL COMPONENTS OF THE ECONOMY**

### Introduction

Small business enjoys a tradition of infinite variety and solid achievement. It thrives everywhere, from New York to Saginaw in the United States, to Tokyo and Kinshasa (Zaire) overseas. So vital is small business that few, if any, parts of the global economy could go on without its products and services. Small business is also a civilizing influence, rising above dollars and cents to enrich the lives of men and women the world over.

###  WHAT IS SMALL BUSINESS?

Specifying any size standard to define is necessarily arbitrary, because people adopt different standards for different purposes. A business may be described as ‘small’ when compared to large firms, but “large” when compared to smaller ones.

 There are two approaches to define small Business. They are:

1. *By some measure of size/*size criteria
2. *Using an economic /control definitions*

***1. Size Criteria***

Even the criteria used to measure the size of business vary. Some criteria are applicable to all industrial areas, while others only to certain types of business. Examples of criteria used to measure size are: ***Number of employees, Sales volume, Asset size, Insurance enforces, Volume of deposits.***

Although the first criteria listed number of employees above employee- it is the most widely used yardstick, the best criteria in any given case depends upon the user’s purpose.

To provide a clear image of the small firms, the following general criteria for defining a small business are suggested:

* Financing by one individual or a small group.
* Except for its marketing operations are geographically localized.
* Compared to the biggest firms in the industry is small.
* The number of employees in the business is usually fewer than 100.

But For example a small executive search firm- a firm that helps corporate clients recruit managers from other organization- may operate in many section of the country.

***2. Economic /Control Criteria***

The economic /control definition covers *Market share, Independence, Personalized management.* All three of these characteristics must be satisfied if the business is to rank as a small business.

1. ***Market share***: - it is not large enough to enable it to influence the prices of national quantities of goods sold to any significant extent. *It*is a company’s product sales as a percentage of total sales for that industry in economic terms.
2. ***Independence***: - Means that the owner has control of the business by himself. that it does not form part of a larger enterprise is relatively free from outside control in its principal decisions.
3. ***Personalized management***: - management of firm by its owner(s) in a personalized manner. Ii is the most characteristics factor of all. It implies that the owner actively participates in all aspects of the managements of the business, and in all major decisions-making processes. There is little delegation of authority.

Based on the above mentioned two criteria, we can have three types of small businesses. These are:

**1. Family Enterprises**: Are locally owned and operated, often by one person called a sole proprietor. Proprietors may have started their business in an effort to supplement or replace family income. Family owned business varies widely and can include retail stores, small manufacturing firms, and restaurants among others. In the absence of a successor, the life of a venture is limited to the working life of its founder. Succession is a serious problem.

**2. Personal service Firms (PSF):-** Rely crucially on unique skills of their founders or key employees. In most instances, the business is the person, and successions are unlikely unless a son or daughter develops comparable skills.

**3. Franchise:-** These are created by contract; an individual receives specific help and advantages in exchange for a franchise fee and, usually, a percentage of sales. The franchisee may receiver franchise help, training, guaranteed supplies, a protected market, and technical assistance with matters such as site selections, purchasing, accounting, and operations management.

* 1. **Significance and Role of Small Business**

As part of business community small firms unquestionably contribute to the nation’s economic welfare. They produce a substantial position of the total goods and services. Thus, their general economic contribution is similar to that of big business. Small firms, however, possess some qualities which make them more than miniature versions of big business corporations. They provide new jobs, introduce innovations, stimulate competition, aid big business, and produce goods and services efficiently.

**Job Creation: -** The energy, creativity and innovative abilities of small business owners have resulted in jobs for other people. As the population and economy grow, small businesses must provide many of the new job opportunities.

**Introduce innovations: -** Strength of small business is their ability to innovate and bring significant changes and benefits to customers. They provide fresh ideas and usually have greater flexibility to change them into large companies. promotes competition in the market which acts as a check in the activities of monopolists, utilize waste product from big firm for further production.

**Stimulate economic competition:-** In a competitive situation the individual business person driven by self-interest is motivated to act in a socially desirable manner. It is competition that acts as the regulator to transform selfishness into service.

**Aid big business:-** The fact that some functions are more expertly performed by small business enables small firms to contribute to the success of larger ones. If small businesses were suddenly removed from the contemporary scene, big businesses would inefficiently perform. Two functions which small business can perform more efficiently than big business are the

* Distribution function: Few large manufacturers of inexpensive consumer products find it desirable to own wholesale and retail outlets.
* Supply function: Small businesses act as suppliers and subcontractors for large firms. General Motors, for example, purchases goods and services from more than 37,000 small businesses. Over three fourths of these small firms employ fewer than 100 persons.
	1. **Causes for Small Business Failure**

Every year many small business firms cease operations. The major reasons for the business failure are:

* Incompetence- the owners simply do not know how to run the enterprise.
* Lack of experience in the line- the owner has entered a business field in which he or she has very little knowledge.
* Neglect- the owner does not pay sufficient attention to the enterprise.
* Fraud- involves intentional misrepresentations or deception (purchasing materials or goods for him/herself with the company’s money)
* Disaster- refers to some unforeseen happening.

The following are specific managerial causes of small business failure

* Inadequate records- unable to establish an adequate record keeping system.
* Expansion beyond resources or Failure to effectively diversify market.
* Lack of marketing research and Lack of information about customer
* Nepotism - favoritism toward family members and other Legal problems
* One person management and lack of technical competence.
	1. **Small Business Success Factors**

**Success Factor 1 - Choice of Business: -** Why have you chosen this business? Are you passionate about this particular business, or just about being in business? Whether fixing fenders, baking bagels, or sewing suits, you must love the business you're in. Merely being passionate about being in business won't get you through the days when the details of business turn against you. One very important success factor is choosing a business that is going to be vital for as long as you can reasonably foresee. But take care not to fall in love with the wrong business.

**Success Factor 2 - Education and Experience:-** The important question that need to be answered by every entrepreneur “Which is more important: Education or experience?" It is known that plenty of highly educated business failures, as well as many highly successful business owners who are not very well educated. Education and experience are both important success factors. Identify where you are deficient and acquire what you don't have.

**Success Factor 3 – People :-** This success factor people can be broken into three groups:

*Internal Team:* These are the founders and the key employees who make the company work. A well-capitalized company with a weak and poorly functioning team is not as valuable as an undercapitalized company with outstanding people. People are not fungible like money. Good people are actually considered rare, even precious. Many winning strategies have been built around one person or team

*External team***:** These are the paid professionals. Every business has them, but in small businesses they become de facto vice presidents. Choosing this team is a critical element in success.

*Connections:* It is better to use the term, network: your community of marketplace friends. Leveraging your network give you access to more intangibles.

**Success Factor 4 - Creativity in Management: -** Every small business needs the creative influence of an entrepreneur, PLUS the steady hand of a manager. But here are two cold, hard truths: some entrepreneurs are not good managers and some excellent managers don't have a creative bone in their bodies. Be honest with yourself. If you're an entrepreneur through-and-through, sell what you create quickly, like when an inventor licenses an invention, or hire a good manager to run what you have created.

**Success Factor 5 - The Industry: -** This factor ties in closely with Success Factor 1 - Choice of Business. It encourages you to find out if the industry you are considering has high potential or low potential. The definitions of high and low potential might seem intuitive, but not always. *High Potential Intuitive* -Obviously, a high potential industry is one that's emerging, or at least hasn't spent too much time on the maturity continuum. Much of the technology industry would fit this profile. Doug says a high potential industry is also one that affords a low capital investment, and/or one where you can operate with a small number of employees. *Low Potential Intuitive* - Doug says industries that are capital and people intensive, and/or highly specialized, are also examples of those with low potential.

*Counter-intuitive* - You might be the problem; low potential could be associated with the business owner. If you start a business that has high potential, but you lack adequate capital, experience, or other key elements of success, you have created low potential for your entry into that industry.

**Success Factor 6 – Records: -** This factor ties closely with Success Factor 2 - Education/Experience. This is one area where education usually trumps experience. A business owner long on experience but short on education will typically be more likely to rely on instinct than documentation. The more educated business owner, on the other hand, will be more comfortable creating data and managing with it. But they must learn how to apply those rules effectively in the marketplace. Business owners with significant marketplace experience must acquire an understanding and appreciation for how sophisticated data collection and processing can leverage their experience.

**Success Factor 7 - The Corridor Principle: -** This factor is closely related to Success Factor 5 - Choice of Industry. Doug defines the Corridor Principle as "the concept where an entrepreneurial venture may significantly change focus from the venture's initial concept through a continuous response to the market and the desire to optimize profitability." Doug puts the Corridor Principle last because the best way to adhere to it is to have the other six factors adequately covered. No matter what business you're in, you need to be operating with what the Three-Strategy Principle: 1) *the current strategy* - the one you're in the marketplace with right now. 2) *The next strategy* - the R&D is done and it's on the shelf ready to deploy when the current strategy plays out. 3) The *quantum leaps strategy* - the one you're investing in today so it's ready to follow #2.

Small business success is made up of experience, education, hard assets, and human assets, all deployed in our wonderfully pure and extremely demanding marketplace.

A number of key success factors applicable for any start-up small businesses. Below are some.

**Sell each unit at a profit** - Evaluate each and every product that you sell and determine if you are selling them profitably whether by reducing production cost or increasing its price.

**Continue to reduce overhead costs** - A lower overhead should be a continuing objective for your business. Evaluating your insurance and consultancy need, cutting unnecessary supplies and equipment.

**Develop new products while maintaining the high quality of existing products** - Ensure that your products are created or chosen in response to the needs of your customers. Ask for customer and find items that they need and expect from your business.

**Find and retain high-value customers -** The 80-20 rule of business states that 80 percent of your business will come from 20 percent of your customers. It is therefore critical that you exert the extra effort to ensure that you retain the business of your top customers. And give your customers more than they expect and satisfied them.

* 1. **Setting small Business**

**What is basic business idea?**

- It is logical to think of a goal for the unit in long run rather than to look for the immediate tomorrow. This long-term thinking is called ***basic business idea***.

- The basic business idea and the product through hierarchy can be represented as follows

|  |
| --- |
| **BBI**  |
| Product Line  |
| Product Range  |
| Product  |

**Figure: Hierarchical presentation of business idea**

Business persons should think of long-term goal and the profit when they start a business. The basic business idea, which is at the top of the hierarchy, is to meet the broadest needs of the customers, and has the long life perhaps from 5-50 years. The basic business idea facilitates choice of product under an overall plan. Thus, entrepreneur may think of being in the entertainment film, in automobiles, in medicines, in services, in industries, etc.

The product line consists of different families of product. A unit with a basic business idea for example packaging can manufacture any of the following groups of the products: glass bottles, plastic packages, metal packages, aluminum packages, paper or wood packages.

The product range includes different size of the product with in the product line, in the examples given above different size of glass bottles can be manufactured for varied applications.

The product is one item of the product range having different specifications like size, material used and weight, etc.

The basic business idea, which facilitates a choice of the product at different stages of the product, allows for diversification and expansion. But the basic idea is not always the same. In a dynamic business scheme, one has to carefully watch is one of the basic ideas degenerating as regards *its ability to generate quick returns and its ability to permit quick changes in the products.* The general business atmosphere guides the choice of basic business idea. A basic business idea results from the identification of business opportunities in the market.

**SOURCES OF NEW IDEAS**

Some of the more frequently used sources of ideas for new entrepreneurs include consumers, existing companies, distribution channels, the federal government, and research and development.

**1. Consumers:** Potential entrepreneurs should pay close attention to the final focal point of the idea for a new product or service-the potential consumer. This attention can take the form of informally monitoring potential ideas and needs or formally arranging for consumers to have an opportunity to express their opinions. Care needs to be taken to ensure that the idea or need represents a large enough market to support a new venture.

**2. Existing Companies:** Potential entrepreneurs and intrapreneur should also establish a formal method for monitoring and evaluating competitive products and services on the market. Frequently, this analysis uncovers ways to improve on these offerings that may result in a new product that has more market appeal.

**3. Distribution Channels:** Members of the distribution channels are also excellent sources for new ideas because of their familiarity with the needs of the market. Not only do channel members frequently have suggestions for completely new products, but they can also help in marketing the entrepreneur's newly developed products.

**4. Federal Government:** The federal government can be a source of new product ideas in two ways. First, the files of the Patent Office contain numerous new product possibilities. Although the patents themselves may not be feasible new product introductions, they can frequently suggest other more marketable product ideas. Several government agencies and publications are helpful in monitoring patent applications. Second, new product ideas can come in response to government regulations.

**5. Research and Development:** the largest source of new ideas is the entrepreneur's own "research and development," efforts that may be a formal endeavor connected with one's current employment or an informal lab in the basement or garage. A more formal research and development department is often better equipped and enables the entrepreneur to conceptualize and develop successful new product ideas.

**Creative Problem Solving**

*Creative problem solving is a method for obtaining new ideas focusing on the parameters.* Creativity is an important attribute of a successful entrepreneur. Unfortunately, creativity tends to decline with age, education, and lack of use. Creativity declines in stages, beginning when a person starts school. Also, the latent creative potential of an individual can be stifled by perceptual, cultural, emotional, and organizational factors. Creativity can be unlocked and creative ideas and innovations generated by using any of the creative problem-solving techniques such as:

**1. Focus Groups:** *Focus groups* have been used for a variety of purposes since the 1950s. A moderator leads a group of people through an open, in-depth discussion rather than simply asking questions to solicit participant response. For a new product area, the moderator focuses the discussion of the group in either a directive or a nondirective manner. *Focus group is groups of individuals providing information in a structured format.*

**2. Brainstorming:** The *brainstorming* method for generating new product ideas is based on the fact that people can be stimulated to greater creativity by meeting with others and participating in organized group experiences. When using this method, the following four rules should be followed: **1)** No criticism is allowed by anyone in the group - no negative comments. **2)** Freewheeling is encouraged-the wilder the idea the better. **3)** Quantity of ideas is desired-the greater the number of ideas, the greater the likelihood of the emergence of useful ideas. **4)** Combinations and improvements of ideas are encouraged; ideas of others can be used to produce still another new idea.

**3. Problem Inventory Analysis***:* instead of generating new ideas themselves, consumers are provided with a list of problems in a general product category. They are then asked to identify and discuss products in this category that have the particular problem. This method is often effective since it is easier to relate known products to suggested problems and arrive at a new product idea than to generate an entirely new product idea by itself Problem inventory analysis can also be used to test a new product idea. *Problem inventory analysis is a method for obtaining new ideas and solutions by focusing on problems.*

**4. Reverse Brainstorming: -** *Reverse brainstorming* is similar to brainstorming, except that criticism is allowed. In fact, the technique is based on finding fault by asking the question, "In how many ways can this idea fail?" Since the focus is on the negative, care must be taken to maintain the group's morale. Reverse brainstorming is a group method for obtaining new ideas focusing on the negative*.*

**5. Forced Relationships: -** *Forced relationships,* as the name implies, is the process of forcing relationships among some product combinations. It is a technique that asks questions about objects or ideas in an effort to develop a new idea. The new combination and eventual concept is developed through a five step process: *1)* Isolate the elements of the problem. *2)* Find the relationships between these elements. *3)* Record the relationships in an orderly form. *4)* Analyze the resulting relationships to find ideas or patterns. *5)* Develop new ideas from these patterns.

**6**. **Collective Notebook Method:** In the *collective notebook method,* a small notebook that easily fits in a pocket containing a Statement of the problem, blank pages and any pertinent background data-is distributed. *Collective notebook method is developing a new idea by group members regularly recording ideas*.

**1.6. STEPS IN SETTING A SMALL BUSINESS UNIT**

The process of starting a new venture is embodied in the *entrepreneurial process,* which involves more than just problem solving in a typical management position. An entrepreneur must find, evaluate, and develop an opportunity by overcoming the forces that resist the creation of something new. The process has four distinct phases: Although these phases proceed progressively, none is dealt with in isolation or is totally completed before factors are being dealt with in a sequential phase. For example, to successfully identify and evaluate an opportunity (phase 1), an entrepreneur must have in mind the type of business desired (phase 4).

1. ***Identify and Evaluate the Opportunity:*** *Opportunity identification, the process by which an entrepreneur comes up with the opportunity for a new venture.* It is quite a difficult task. Most good business opportunities do not suddenly appear, but rather result from an entrepreneur's alertness to possibilities or, in some cases, the establishment of mechanisms that identify potential opportunities. Although most entrepreneurs do not have formal mechanisms for identifying business opportunities, some sources are often fruitful: consumers and business associates, members of the distribution system, and technical people. Whether the opportunity is identified by using input different sources must be carefully screened and evaluated. This evaluation of the opportunity is perhaps the most critical element of the entrepreneurial process, as it allows the entrepreneur to assess whether the specific product or service has the returns needed for the resources required. This evaluation process involves looking at the creation and length of the opportunity, its real and perceived value, its risks and returns, its fit with the personal skills and goals of the entrepreneur, and its differential advantage in its competitive environment.

It is important for the entrepreneur to understand the cause of the opportunity. Is it technological change, market shift, government regulation, or competition? These factors and the resulting opportunity have a different market size and time dimension. The market size and the length of the *window of opportunity* form the primary basis for determining risks and rewards. *Window of opportunity is the time period available for creating the new venture.*

Finally, the opportunity must fit the personal skills and goals of the entrepreneur. Although many entrepreneurs feel that the desire can be developed along with the venture, typically it does not materialize, therefore dooming the venture to failure.

An opportunity analysis plan includes the following: a description of the product or service, an assessment of the opportunity, an assessment of the entrepreneur and the team, specifications of all the activities and resources needed to translate the opportunity into a viable business venture, and the source of capital to finance the initial venture as well as its growth-first and second stage financing.

1. ***Develop a Business Plan: -*** *Businesses plan is the description of the future direction of the business.* A good *business plan* must be developed in order to exploit the defined opportunity. This is perhaps the most difficult phase of the entrepreneurial process. An entrepreneur usually has not prepared a business plan before and does not have the resources available to do a good job. A good business plan is not only important in developing the opportunity but also essential in determining the resources required, obtaining those resources, and successfully managing the resulting venture.

***3. Determine the Resources Required:*** The resources needed for the opportunity must also be determined. This process starts with an appraisal of the entrepreneur's present resources. Any resources that are critical must then be distinguished from those that are just helpful. Care must be taken not to underestimate the amount and variety of resources needed. The down- side risks associated with insufficient or inappropriate resources should also be assessed. An entrepreneur should strive to maintain as large an ownership position as possible, particularly in the start-up stage. As the business develops, more funds will probably be needed to finance the growth of the venture, requiring more ownership to be relinquished. Every entrepreneur should give up an ownership position in the venture only after every other alternative has been explored. Alternative suppliers of these resources, along with their needs and desires, must be identified.

***4. Manage the Enterprise:*** After resources are acquired, the entrepreneur must employ them through the implementation of the business plan. The operational problems of the growing enterprise must also be examined. This involves implementing a management style and structure, as well as determining the key variables for success. A control system must be identified so that any problem areas can be carefully monitored. Some entrepreneurs have difficulty managing and growing the venture they created. This is one difference between entrepreneurial and managerial decision making.

* 1. **Problems in Ethiopian Small business**

1. Lack of Adequate finance and Credit

* Don’t have easy access to Capital Market mostly because they are organized on proprietary, partnership and there size is very small.
* Don’t have access to Industrial source of finance because of their size and their surplus can be utilized to repay loans are negligible

2. Production

* Difficulty of Getting raw material of good quality and at cheaper rate in time
* Hence, they fail to produce Goods in: Requisite Quantities, good quality and low cost.
* Outdated Techniques of Production.
	+ Poor Financial position → Unable to buy new equipment → Productivity suffers.
1. Lack of Market Outlets/Problems of marketing their products.