Towards Small Business Problem Classification: A Conceptual Model

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Abstract
Today’s business environment is turbulent and requires firms, small or large, to be proactive and innovative rather than reactive and receptive if they are to survive and grow in it. Strategic awareness is a mental process of continually evaluating organisational and environmental problems and improvement on how they are identified, recognised, influenced and interpreted, and consequently used in making managerial decisions. However, due to the apparent lack of resources and expertise, Small and Medium Enterprises (SMEs) put greater emphasis on short-term survival issues than long-term competitiveness and dynamism. This paper develops and examines a conceptual model of SME problem classification for designing meaningful assistance schemes and entrepreneurial development programmes. Based on literature reviewed, the proposed model opposes the common practice of putting greater emphasis on short-term internal problems and operational efficiency instead of developing strategic awareness and long-term competitiveness. Although this could be attributed to lack of resources and expertise required for the formulation and implementation of strategies, the proposed model advocates the need for strategic thinking and awareness. SMEs must be assisted to understand the implication of operational and short-term problems in their long-term survival and competitiveness. SMEs stakeholders must redirect their efforts toward bridging the gap between short-term operational efficiency and long-term competitiveness and sustainability. This paper has two relevant implications. First, future research must test and validate the proposed conceptual model. Second, SMEs stakeholders can modify and incorporate the different dimensions of the proposed conceptual model in the designing and implementation of SMEs assistance programmes.

The Study and Classification of Business Problems
The problems and performances of SMEs have been studied from a variety of approaches to better understand why some firms fail and why others succeed. Recognising the dynamic relationship between the firm and its operating and environmental characteristics, Keats and Bracker (1988) proposed a conceptual model of small firm performance. This model suggests that performance outcomes are a function of many variables, including owner characteristics, owner behaviour and environmental influences. Their model, grounded in strategic, entrepreneurship, organisational theory, transcends the belief that small firms are merely miniature versions of large businesses and recognises small firms as unique entities. Their model consists of six constructs: (a) Entrepreneurial Intensity, which deals with entrepreneurial characteristics and behaviours of owners managers; (2) Task motivation, which include the intensity of entrepreneurial motivation to attain goal
achievement; (3) Perceived strength of environmental influences, which deals with the owner manager’s strategic choices and reactions in response to environmental elements; (4) Behavioural strategic sophistication, which consists of the acquisition and implementation of sophisticated strategic management practices; (5) Cognitive strategic sophistication, which deals with comprehension and integration of strategic management practices; and (6) Task environment factors, which include the structure of the industry in which the organisation operates.

The model proposes that these six constructs have substantial influence on the performance of SMEs. The model provides the basis for explaining how strategic awareness, behavioural sophistication and contextual factors relate to the problems and performance of SMEs.

Organisational life cycle models were also used to study the problems of SMEs. Proponents of this model (Dodge and Robbins 1992; Watson and Everett 1993 and Dodge, Fullerton and Robinson 1994) argue that greater knowledge of how SMEs evolve and the major obstacles faced in various life cycle stages have critical importance to fully understand the problems of SMEs and types of assistance necessary for their survival and growth.

Organisational life cycle models hold that organisational activities and structures in one stage of development are not the same as that in the preceding or following stages. Thus, with different emphasis and operating context, each stage of development will have a different set of problems.

The other assumption in this model is that what management of, say an SME, does or does not do with respect to current problems propel the transition to the next stage. Problems therefore may carry from stage to stage or be unique to a particular stage. The problem with this approach is lack of emphasis on the need to fill the gap between short term and long term issues within each developmental stage.

The application of functional models was based on the assumption that SME problems can be conveniently divided into business functions. Hguang and Brown (1999) grouped organisational problems into 5 functional areas [(1) human relations, (2) accounting and finance; (3) marketing; (4) internal management, and (5) external management. They concluded that the most prevalent areas in which SME have problems are sales / marketing, human resource management, and general management. Industry models were designed to study problems by industry or sector whereas firm size models are based on the justification that the problems of small,
micro, medium and large firms are somehow different and can be effectively studied separately.

Understanding the nature and types of SMEs problems will substantially help policy makers, practitioners, researchers, consultants and other SME support groups to better serve the SME sector. This understanding is very important in identifying and developing relevant small business assistance programmes and schemes. Since small business problems are numerous and complex, there is strong need to develop an integrated model of SMEs problem classification which incorporates all the problems identified using the life cycle model, state of development model, functional models, industry and firm size related models.

Some problems are internal to SMEs and within the control of management while others are external and outside the control of management. But, most studies have not addressed the operational-strategic gap in responding to these problems. Managerial responses to organisational problems could be operational or strategic depending on whether the immediate impact of the problem is on the short-term or long-term performance of SMEs.

A Conceptual Model of Problem Classification

Enhancing the survival and performance of SMEs must be based on clear understanding of the nature and types of problems affecting them. Since SMEs problems are numerous and complex, there is a strong need for a systematic model or framework to conceptualise and operationalise their causes and effects.

The literature identifies and groups SMEs problem into different categories. However, only few studies have attempted to examine the strategic (long term) and operational (short term) implications of the problems under the various categories. Particularly drawing from the original works of Boyle and Desai (1991) and Keats and Bracker (1988), this paper proposes a conceptual model of SMEs problem classification. Temtime, et al., (2004) argued that SMEs assistance will be meaningful if a model (decision tree model) is used to match problems with support packages.

As shown in figure 1, the model is a simple 2x2 matrix, with the vertical axis distinguishing between internal and external problems based on whether they are part of the firm’s internal environment and are under management’s control or whether they are part of the firm’s external environment and are beyond management’s control. This division of SME problems as internal-external will help separate the critical factors within and outside the control of management, which in turn helps to redirect
organisational efforts to effectively address controllable factors while operating under the uncontrollable environment. But, it should be noted that the internal-external continuum (vertical axis) is not a fixed scale with clear demarcation. It is a continuum carrying all possible choices between extremes.

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<td>e.g. Death of Owner/manager; important employees leaving the firm; unreliable suppliers; high liability; lack of training facilities; extra-ordinary event like fire or earthquake; forced to leave business premises; local competition; lack of barriers to new entrants; firm product harming someone.</td>
<td>e.g. lack of integrated business development policy; unavailability of skilled intensive; changing socio-economic trends; globalisation of competition; lack of credit facilities; rapid technological changes; high bank collateral for loan/credit stringent loan repayment terms; high interest rates on loans.</td>
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<td>e.g. lack of functional planning and budget; ineffective recruitment practices and dependency on family intensive; lack of delegation; Lack of quality control; lack of financial record keeping; poor working capital management; lack of effective product/service marketing; lack of information on markets/customers and lack of proper organisational structure</td>
<td>e.g. lack of strategic business planning; ineffective human resources policy and procedures; poor financial planning and control; misperception of marketing as advertising; organisational misalignment; lack of participative management; lack of standardization of products and services and absence of formalisation of working procedures.</td>
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**OPERATIONAL STRATEGIC**

Figure 1: A Model of SMEs Problem Classification (Adopted from Boyle and Desai 1991; Keats and Bracker 1988).
The horizontal axis divides the problems based on whether they are operational / administrative, or strategic in nature. Some SMES problems exert greater influence in the short term than in the long term and vice versa (Pineda et al 1998 and Lang et al 1997). Although it is not easy to put a clear demarcation between operational and strategic issues, the continuum allows the use of judgment and imagination in evaluating the expected impact of problems on short and long term performance of SMES. This classification of problems as operational-strategic will enable SMES stakeholders to differentiate and prioritise problems affecting long-term competitiveness and short-term operational efficiency.

**Internal-Operational Cell (Cell 1)**

The problems within the internal-operational Cell (Cell I) are internal to SMES, within the control of management and require immediate administrative or operational response. The most appropriate way to counter these types of problems is through routinely administered procedures. These routine actions generally produce the expected results, as there is little uncertainty in what to expect after taking action (Cowan 1990). A routine review of financial and cost accounting information, for example, can often yield, without uncertainty or ambiguity, information necessary to take appropriate actions. It is another matter if the firm decides not to take action. Urgent managerial actions must be taken when the firm misses deadlines, experiences high intensive turnover, increased production costs, and/or decreased sales volume.

It is the degree of managerial competence and skill in solving these problems that determine the short-term survival of SMEs. Larson and Clute (1979) have long recognised that the numerous characteristics shared by failed firms are directly related to; (1) personal decision based characteristics of the owner manager—lack of insight, inflexibility, emphasis on technical skills, lack of delegation, etc; (2) managerial deficiencies—lack of management skills and appropriate managerial training, lack of managerial experience, etc; and (3) financial shortcomings—lack of accounting background, cash flow analysis, financial records, financial planning and control.

According to Monk (2000), the most important reason for small business failure, regardless of stage of development, industry, size, or business functions, is the inability of SMES to make adequate use of essential business and management practices. Monk argues that many SMES fail to develop initial plan, and those that do establish a plan fail to continually adjust and use it as a benchmarking tool.

A plethora of studies (Temtime 2004b and Huang and Brown 1999) showed that either because of the lack of awareness of management processes and tools, or because
of lack of funds to outsource these skills, proper business planning takes a second seat to the technical side of the business. Haswell and Holmes (1989) argue that owner managers feel comfortable in the environment with which they are accustomed.

As the firm grows and managerial planning and control become more critical, they will look to hire someone to help, but are often resistant to giving up some of the control. While SMES will consult with their accountants, bankers and peers for advice on business matters, they do not all make extensive use of modern management techniques or benchmarking tools. They are not aware of the benefits of these tools, and do not have access to professionally qualified and economical business advisory services that can apply them (Pineda et al. 1998; Williams 1993; Sasbauer and Baker 1993 and Yosuf and Aspinwall 2000).

At first glance, it is apparent that the majority of SME problems cited in the literature fall within this internal-operational cell of the proposed model. Examples of internal-operational problems include: Lack of proper functional planning and budgeting; (Temtime 2002; 2004b); ineffective employee recruitment and selection practices, and dependency on family labour (Gatewood and Field 1987); lack of delegation: owners or managers insisting on doing everything themselves (Hornsby and Kuratko 1990); lack of financial record keeping, documentation and analysis of financial statements (Watson and Everett 1993 and Wichmann 1990); poor working capital (cash, inventory, account payable and account receivable) management (Wichmann 1990); excessive cash withdrawals for personal consumption as sales begin to rise (Williams 1993); lack of marketing products and services particularly during the first few years (Romano and Ratnatunga 1995); lack of proper organisational structure showing clear division of labour, flow of information and authority / responsibility chain (Drucker 1984).

All these problems are within the control of management. From this model it can be observed that inability to respond to the administrative or operational problems is the major cause of business failure. Most SMES and even support programmness believe that solving these problems ensure success in the future. This may improve short-term operational efficiency, but may not guarantee the long-term competitiveness of SMES (Smallbone 1990 and Sasbauer and Baker 1993). Achieving competitive advantage calls for strategic awareness and moving beyond the operational bits and pieces, i.e., moving to the internal-strategic cell.
Internal-Strategic Cell (Cell II)
The internal-strategic cell (Cell II) deals with issues that are internal to the firm, but, require a response and actions that are strategic as opposed to operational. Most SMEs fail to move to this cell and remain in cell I until they die. A strategic response affects the long-term prospects of the firm, and the results are usually uncertain. Formal strategic planning, HRM policy, marketing research, financial planning and control, all do not necessarily guarantee market success (Haswel and Holmes 1989). The factors within this cell emphasise the areas requiring strategic initiation within a firm.

The human resources problem, for example, looks at human resources from the strategic point of view and illustrates how certain human resource issues (such as small business owner’s inability to perform both administrative and planning functions; high employee turnover; problems of excessive reliance upon family labour; lack of employer legitimacy and recruitment policies; extended employee benefits and incentives) can be of strategic importance to the firm. SMES assume that formal strategic business planning is costly, time-consuming and hence appropriate for large multi-national, multi-product, multi-divisional companies (Temtime 2004a). Strategic planning considers future possible events and conditions, and strategies to minimise their impact on the performance of the company.

The day-to-day operational efficiency and problem solving activities are all carried out to take the company to its desired position. They are not by themselves ends because SMEs are going concerns. Most SMEs are often preoccupied with the internal-operational problems and do not have the time and resources to address internal-strategic problems because they put greater emphasis on short-term survival issues than on strategic issues.

An important lesson that SMES can learn from this is that responding to the operational problems in Cell I must start by looking at the strategic problems in Cell II. Imagine a problem caused by an unexpected resignation of a key employee who has been the backbone of the company for several years. The traditional approach to problem solving has two alternative solutions. Either to provide the employee with additional incentive and get him/her back to work, or stop business for sometime and find replacement. The problem is not solved successfully until a contingency plan is prepared as a human resource policy for the company (Williamson 2000).

It is therefore argued that SME must understand the long-term strategic implications of the various operational problems they are dealing with, if they want to lay the
foundation for growth and competitiveness. As shown in figure 1, there are many external factors (see Cell III) that may affect short-term functions of the firm. By moving from Cell I to Cell II (i.e., from operational to strategic issues) a firm may consequently and effectively address all external problems in Cell III and Cell IV.

**External-Operational Cell (Cell III)**
The factors in the external-operational cell are products of the firm’s external environment and require operational response from management (Elenkov 1997; Temtime 2004a). Although these problems are beyond the control of management, they can cause sudden and irreparable damage to SMEs. In fact, their effects can be devastating and how management responds to these factors is of critical importance to the future of SMEs.

Since the firm may or may not choose to respond, the action is considered to be under the management’s control. Elenkov’s (1997) study found that most SMEs do not effectively respond to these external factors. Small business owners do not usually delegate part of their authority and responsibility to others. They prefer to do everything themselves. This leaves the firm vulnerable when the owner is incapacitated and cannot manage the firm (Williamson 2000). The prevalence of unreliable local suppliers in the market requires an operational response from management.

This response could be in the form of creating partnerships with some suppliers to ensure timely delivery of products and services (Sasbauer and Baker 1989). An increase in debt from time to time requires an administrative response from management, otherwise it could lead to liquidation of the business. The lack of low cost training facilities in the community shows that management should use various in-house training methods (on-the-job training) to help employees achieve organisational goals effectively and efficiently.

Temtime (2004a) studied external factors affecting SMES and identified inability to analyse their external environment as a major factor affecting their survival and competitiveness. SMES, for example, should know what will happen to the business if the owner dies, if the manager or other key employee leaves, if they are forced to leave the business premise; if an extraordinary event like fire happened; if a product harms somebody; if no training facilities at all in the community; if competition is getting tough; or if new entrants are coming to share the market; and so on.
In short, factors in the external-operational cell require a proactive, rather than a reactive, response from management if SMEs are to improve or maintain their short-term operational efficiency.

**External-Strategic Cell (Cell IV)**

Within this cell lie factors that are external to the firm and require a strategic response. These factors are related to issues essentially out of the control of management. Responding to these factors often necessitates a change in the firm’s strategic direction, and the results of managerial decisions often are uncertain due to many uncontrollable factors (Pineda et al. 1998). Lack of strategic response to these factors will drastically affect the long-term competitive potential of SMEs.

Formalised strategic business planning will have greater contribution to building long term competitive advantages than improving annual or interim profitability. The same is true for market research and information systems. Although these actions are manageable and can be identified as being necessary, their outcomes are less certain compared to those associated with Cell I. Although these factors are beyond the control of management, owners/managers can minimise their impact by developing an outward looking behaviour and strategic awareness (Daft and Weick 1984). Lack of integrated business development policy; unavailability of skilled labour in the economy; economic recession; lack of credit facilities in the economy; or high interest rates and so on, may have strategic influence on SMEs. However, anticipating such problems and preparing flexible contingency plans may significantly reduce their negative impacts. This is the main reason why many companies achieve competitive advantage in an unfavourable business environment, which forces many others into liquidation (Drucker 1984).

**Summary and Conclusions**

To sum up, the proposed model shows the need to place adequate emphasis to all factors in the internal-strategic and external strategic cells. The most important problems cited in this paper are found in Cell I. Governments and SME support agencies put excessive emphasis on these factors on the grounds that the company must first survive to think about long-term competitiveness. For this reason, they put relatively little emphasis on problems with greater influence on long-term competitiveness than on short-term profitability. Thus, while attempting to respond to operational problems (Cell I); do not take into account the long-term implications (Cell II) of their operational decisions.
Moreover, they do not even relate their response to routine internal problems to the possible influences of external-operational problems. While a key employee resigns, for example, a decision would be taken to find somebody to replace him/her. This is a good and fast response to an administrative problem (Cell I). However, SMEs, with some reasonable degree of strategic awareness, develops or revises employee training and development policy (Cell II) with the view to minimise the impact of external uncontrollable problems (Cell III) such as future employee turnover.

Thus, lack of long-term perspective in responding to administrative issues can seriously affect the survival and growth of SMEs. Although the most commonly cited cause of SME failure is “poor management”, studies have found that only very few managers of companies that fail accept “poor management” as a major cause of their failure. Most of them blame the external environmental factors in Cell III and IV. If nothing is done, continued managerial failure to actively respond to internal operational problems (Cell I), might lead to the perception of these problems as external to the firm. The external environment cannot be blamed in this respect as there are many other similar companies succeeding under the same operating environment (Drucker 1984).

Although several approaches have been used to study the problems of SMEs, most of them are fragmented and need some form of integration. The organisational life cycle or stage of development model focuses on the nature and types of problems that SMEs face during their introductory, growth, maturity and decline stages. Functional models study problems of SMEs within business functional areas, and nothing else. Industry models examine business problems industry-by-industry and sector-by-sector.

Firm Size Models study the problems of micro, small, medium and large firms separately. From this, one can infer that there is a strong need for a unified comprehensive model that can be applied to different stages of development, life cycles, functional areas, and industry and firm sizes. The proposed model of SME problem classification combines operational efficiency with long-term competitiveness through a proactive and strategic response to internal and external problems. It emphasises the need to systematically progress from exclusively focusing on internal-operational problems to external-strategic issues through external operational issues.

This paper has important implications to future research and SME support agencies. Future research may empirically test, validate or invalidate the proposed model of
SME problem classification model by collecting empirical data from SMEs on their perceptions of business problems defined as internal/external and operational/strategic. Future research should also pay adequate attention to the conceptualisation and operationalisation of the model under different socio-economic conditions. SME’S support agencies may use the proposed model for understanding the nature of problems SMEs are facing and the types of managerial reactions or responses needed to achieve long term competitiveness. Understanding the short-term and long-term impacts of internal and external problems may enable SME support agencies to design training programmes and advisory services that focus beyond solving day-to-day routine problems.

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References


