

**IS STRATEGY DIFFERENT FOR VERY SMALL AND NEW FIRMS?**

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**ABSTRACT**

*In this paper, we argue that much of the small business strategic management literature has drawn too heavily from work done on large, established firms. We build upon the notions of the liabilities of smallness and newness to discuss how microenterprises and very new firms are different in regards to their strategic analysis, strategic content, strategic resources, and strategic processes. We note that there are a number of important and non-obvious questions that need to be asked that have implications for the most common firms in the world, those that are very small.*

**Keywords:** Strategy; Microfirms; Small business; Entrepreneurial orientation

**INTRODUCTION**

Is strategy different for very small businesses, including solo entrepreneurs? Most studies of strategic management found in the research literature posit theories about larger companies and use data sets from

established organizations or publicly-traded firms. Although there is a body of literature about small business strategy, for which this journal is a prime example, much of that literature draws on perspectives developed for large firms. Further, a quick review of the leading small business management and

entrepreneurship texts reveals two things: a) strategic management occupies a small number of pages; and, b) most of what is offered in the form of strategic thinking is adapted from studies of large, established companies.

In this paper, we examine the implications of deriving small business strategic thinking from big business research. We are especially interested in how this might apply to very small and very young firms. Perhaps the concepts and findings from the broader strategy literature can easily be applied and there is no reason for concern. But it is our belief that at least some aspects of small business planning, strategizing and competitive positioning will be significantly different for the smallest of firms. For instance, one study compared the effects of industry on firm performance on new and small versus large and established firms (Short, McKelvie, Ketchen & Chandler, 2009). This research showed that industry impacts smaller and new firms substantially less than their large counterparts. The authors suggest that this may be due to the differing ways that these types of firms compete. Understanding how and why the strategic management literature may differ for the smallest and newest of firms is important in part because of the huge number of microenterprises and solo entrepreneurs. In his book *Free Agent Nation*, published in 2002, Daniel Pink reported that in the U.S. alone, about 25 million citizens are self-employed (Pink, 2002). Further, approximately 4-6% of the adult population joins the list of entrepreneurs each year (Reynolds & White, 1997). These numbers are growing and are likely far greater when considered as a global phenomenon. The number of microbusinesses that have recently been spurred by the surge in microlending and the vast amount of commerce being carried

on in the informal economy suggests that there could be many millions of small business founders and owners who would benefit from a clearer understanding of small business strategy.

To address these issues, we evaluated components of strategic management in terms of two concerns that solo entrepreneurs and new, very small businesses face: the liability of newness and the liability of smallness. The liability of newness (Stinchcombe, 1965; Freeman, Carroll & Hannan, 1993) refers to the risks of failure that new firms experience because their organizational roles and routines are underdeveloped, and they lack trust relationships and established customers. These features contribute to low levels of legitimacy that make it relatively more difficult for young firms to thrive in a competitive environment. The liability of smallness refers to the risk of failure associated with firm size (Aldrich & Auster, 1986; Wholey, Christenson & Sanchez, 1992). Because very small organizations typically lack economies of scale, have difficulty raising capital, and are relatively more vulnerable to fluctuations in the marketplace, they find it difficult to effectively compete. The question we asked is whether the major components of strategy that have been useful in understanding larger firms—strategic analysis, strategic content, strategic assets/capabilities and strategic processes—can also be applied to microenterprises, that is, solo entrepreneurs and very small firms.

The remainder of the paper proceeds as follows. In the next section, we elaborate on how the liabilities of newness and smallness might impact the manner in which a microenterprise views strategy. Then we evaluate the following components of strategy from the literature on strategic

management in large organizations: Strategic Analysis including SWOT analysis, 5-Forces analysis and Value Chain Analysis; Strategic Content including the generic strategies of cost leadership vs. differentiation; Strategic Assets/Capabilities including the resource-based view of the firm; and, Strategic Processes including entrepreneurial orientation. This is followed by a section in which we consider entry strategies, and a discussion and implications section that addresses future research directions.

### **MICROENTERPRISES AND THE IMPACT OF SMALLNESS AND NEWNESS**

The focus of this inquiry is microenterprises and solo entrepreneurs. We find little value in distinguishing between the two as self-employed entrepreneurs are regarded as a type of microenterprise. Given that a microenterprise can consist of one employee, the more salient question might be how large can a microenterprise be? This varies slightly in different parts of the world. In the U.S., the Association of Enterprise Opportunity regards microenterprises as those with 5 or fewer employees, including the lead entrepreneur. The European Union caps the number of employees at 10; Australia labels single-owner businesses with up to 20 employees as microenterprises (Association for Enterprise Opportunity, 2012). In the developing world, we know of no defined limit but many involve solo entrepreneurs. Based on these various perspectives, we define microenterprises as small businesses with no more than 10 employees including the founder. In a recent year, the number of U.S. firms with employees that fit that description was approximately 4.7 million (U. S. Small Business Administration, 2012). Microenterprises may have full-time

employees, part-time employees or family members working in the business. The enterprise itself may be a part-time or seasonal business. In recent years, the number of individuals who filed sole proprietor tax returns in the US—which can include both part time and full time business—has been about 23 million (U.S. Internal Revenue Service, 2012)

We are also interested in the role that liability of newness might play in the strategic management of microenterprises. Prior researchers have concluded that, in general, new ventures remain “young” up until about 7-8 years of age (Biggadike, 1976; Miller & Camp, 1985). Firms that survive beyond 7-8 years are regarded as entering maturity. Hence, consistent with this age convention which can be found in numerous studies of new ventures (e.g., McDougall, Covin, Robinson, & Herron, 1994; Shrader & Simon, 1997), we regard new ventures as those that are eight years old or younger.

Given our definitions, it is not surprising that microenterprises would be vulnerable to liabilities of newness and smallness. Young firms face a number of limitations that can impede their ability to survive and thrive. Several factors contribute to an overarching lack of legitimacy among new firms—few trust relationships, poorly defined organizational roles, absence of efficient operations and established routines, and a general lack of experience. Very small firms also face a number of important impediments because of their size. Lack of financial and human resources, as well as the ability to access such resources is a common plight among small firms. Small firms may also find it difficult to achieve economies of scale or gain recognition as a significant player relative to larger firms. Such conditions are

likely to affect the extent to which microenterprises use strategic tools and pursue strategic initiatives.

Despite these liabilities, smallness and newness bestow certain advantages on microenterprises that should not be overlooked. Relative to large organizations, very small firms may be highly flexible in terms of being able to make decisions and act rapidly. Young firms that are unfamiliar with the norms of an industry may be able to implement new practices.

Microenterprises are often skilled at bootstrapping and may be able to conduct low cost experiments without incurring heavy financial losses. As such, there may be some settings or strategic situations in which smallness or newness endow microenterprises with a comparative advantage.

### **MICROENTERPRISES AND STRATEGIC MANAGEMENT**

In the subsections that follow, we discuss the impact of newness and smallness on the ability of a microenterprise to analyze, devise and deploy strategic plans and actions. The discussion is divided into four major categories of strategic management activity—strategic analysis, strategic content, strategic assets/capabilities, and strategic processes.

#### **STRATEGIC ANALYSIS**

The tools of strategic analysis enable an organization to evaluate their status and performance relative to other firms, industry norms and trends, and conditions in the business environment. It is widely believed that by using such information, companies can more effectively plan new strategic initiatives or adapt existing strategies to achieve goals and reach desired future states

(Becherer & Helms, 2009). Approaches to strategic analysis range from the rather basic, such as scoping out competitors at a trade show, to more complex techniques, such as consultant-developed formal business plans or intricate scenario analysis models. In this section, we consider how solo entrepreneurs and microenterprises can use three such tools—SWOT analysis, 5-forces analysis and value chain analysis—to enhance their strategic planning and decision making.

**SWOT Analysis.** SWOT analysis is a tried-and-true approach to evaluating an organization's strengths (S), weaknesses (W), opportunities (O), and threats (T) (Jackson, Joshi, & Erhardt, 2003). It is a tool for developing an overview of a company's current strategic circumstances that can apply to organizations of any size. By examining strengths, a microenterprise can discover untapped potential or identify distinct competencies that can be leveraged to achieve desired results (Valentin, 2001). By examining weaknesses, an entrepreneur can identify gaps in performance, vulnerabilities, and erroneous assumptions about existing strategies. By examining opportunities, a firm can discover untapped markets, new products or new technologies, or identify potential avenues for diversification. By examining threats, a small business can identify unfavorable market shifts or changes in technology, and create a defensive posture aimed at preserving its competitive position.

SWOT analysis can be highly useful for microenterprises wishing to take stock of their strategic situation and forming a strategy that matches the situation. Without additional analysis, however, such assessments are of little use in developing and enacting a strategy. Instead, the SWOT framework can best be used as a starting

point for analysis in that it provides the “raw material” to conduct more comprehensive internal and external analysis. Very small firms are likely to be seriously constrained in terms of available resources and stocks of human and social capital. A new firm or microenterprise might have a different view of its salient environment in terms of how it defines its competitors or the trends that are likely to affect its business model or prospects for success. For example, a very small software firm operating in a particular niche may have limited opportunities and fewer threats than a major launch developed by Microsoft. Hence, SWOT analysis is context specific.

**Five Forces Analysis.** Another highly recognizable method for assessing strategic conditions is known as 5-forces analysis (Porter, 1980). The purpose of 5-forces analysis is to diagnose the principal competitive pressures in a market and assess how strong and important each one is. The five forces are environmental forces that impact on a company’s ability to compete in a given market. They consist of the bargaining power of suppliers, the bargaining power of buyers, the threat of new entrants, the threat of substitutes and the intensity of rivalry among existing competitors. Five-Forces Analysis is regarded as a framework for analyzing a particular industry because the forces are thought to affect all the businesses in that industry in a similar fashion.

Because it permits a company to assess strategic conditions in an industry, 5-forces analysis is useful for crafting strategies that enable firms to address the influence of the forces. To be successful, strategy must be designed to cope effectively with competitive pressures. The analysis enables a firm to build a strong market position

based on competitive advantage. A company whose strategy and market position provide a good defense against the five forces can earn exceptionally good profits even when some or all of the five forces are strong. Such strategizing should be available to small and/or young microenterprises, as well as firms of other sizes.

However, some of the forces may be especially challenging for a very small business to overcome. For example, microenterprises may have very little bargaining power relative to suppliers who conduct a substantial part of their business with much larger companies (Brown & Butler, 1995). When a microenterprise only represents a small percentage of a supplier’s total business activity, the loss of the microenterprise as a customer would have very little impact on the supplier. Hence, the small business has low bargaining power. Likewise, a microenterprise that has one or a few large buyers might be highly dependent on those buyers to sustain its viability, thus giving those buyers high power relative to the microenterprise.

With regard to the threat of new entrants, smallness may provide some advantages if the business is highly focused on a particular niche. That is, the microenterprise may have such a unique following or operate in such a narrow niche that new entrants may have few opportunities to effectively compete (Cooper, Willard & Woo, 1986). Further, the smallness of the microenterprise’s niche may make competing in that arena unattractive for a new entrant. As for rivalry among existing competitors, to the extent that a microenterprise has many similar competitors, smallness probably makes them relatively more vulnerable when dips in their performance or surges in the

success of a rival changes the dynamics of a given marketplace. Hence, 5-forces analysis can assist microenterprises in identifying both vulnerabilities and promising prospects.

**Value-Chain Analysis.** Value chain analysis is another strategic tool for evaluating an organization's prospects. Whereas 5-forces analysis is principally designed for external analysis of opportunities and threats, value-chain analysis is internally focused on the strengths and weakness that affect how well a firm can compete. A value chain analysis helps identify the activities, functions, and business processes that have to be performed in designing, producing, marketing, delivering and supporting products and services. A company's competitiveness depends on how well it manages its value chain relative to its competitors.

Porter's (1985) value chain framework identified two elements of a strategic value chain. The first is labeled primary activities and refers to a series of actions that are commonly thought to add value in a manufacturing-type setting, that is, in a context where lower value raw materials are converted into higher value goods. These include inbound logistics, operations, outbound logistics, sales and marketing, and service. The second component is referred to as support activities and consists of firm infrastructure, human resource management, technology development, and procurement. According to Porter (1985), support activities are vitally important and can be a strong source of competitive advantage. Because of this, organizations that pay too little attention to support activities are likely to suffer from relatively poorer performance.

The strategic importance of value chain analysis derives from its usefulness in identifying sources of competitive advantage that can be leveraged, as well as potential weakness that may be inhibiting superior performance. By making up for resource deficits and concentrating resources on those activities where the company can gain dominating expertise, an organization can optimize its value proposition. Unfortunately, the liabilities of smallness and newness place microenterprises at a disadvantage relative to most older and larger firms. To a great extent this is because of the analysis tool itself. That is, because value chain analysis focuses on strengths and weaknesses and young, small firms typically have very few of either, it is not a tool that shows how a microenterprise might best use its strategic resources to achieve success.

For example, relative to larger firms, the ability of a microenterprise to add value through the primary activities of sales and marketing or service is highly constrained. A larger firm can devote more resources to sales- and service-related activity, and a young firm will likely have far fewer sales contacts and marketing opportunities. Further, all four of the support activities—procurement, infrastructure, technology development and human resource management—are likely to be more highly developed in established firms than in young or small microenterprises. Hence, value chain analysis has very limited usefulness as a tool to evaluate microenterprises. Further, many of these very small firms may only focus on one particular part of the value chain instead of multiple parts. As such, they may specialize in one narrowly defined activity and collaborate with other firms who can also provide targeted support activities (Hagerdoorn, 1993). A helpful alternative

would therefore be an analysis method that assessed strategic capabilities such as the ability to deploy available resources or leverage network ties to identify and pursue growth opportunities.

### STRATEGIC CONTENT

A great deal of extant work has investigated the strategic content of entrepreneurial ventures. Perhaps the most common research question in this regard concerns whether new firms should pursue narrow or broad strategies (e.g. McDougall, Covin, Robinson, & Herron, 1994; Miller & Camp, 1985). A narrow strategy is pursued when a firm focuses on serving the needs of a particular customer segment or industry niche (Porter, 1980). In contrast, firms utilizing a broad strategy extend beyond individual market segments or niches and attempt to serve an industry-wide range of customers (Porter, 1980). Early scholarship on breadth-related strategic content consistently supported the notion that entrepreneurial firms should pursue a narrow strategy in order to avoid direct competition with large and mature firms (Broom, Longenecker, & Moore, 1983; Buchele, 1967; Cohn & Lindberg, 1974; Hannan, 1976; Hosmer, 1957). However several follow-up studies challenged the prevailing wisdom and suggested that pursuing a broader and more aggressive strategy may be advantageous for new ventures (Biggadike, 1976; MacMillan & Day 1987; Miller & Camp, 1985). Holistically, there is a large body of work which investigates the effects of broad and narrow strategies in new and small ventures.

However, beyond the broad versus narrow question, little research has been conducted on the applicability of traditional strategic content to very small and emerging

ventures. The strategic management literature has generated a number of generic strategies that mature firms may employ in competing with other firms (e.g. Herbert & Deresky, 1987; Hofer & Schendel, 1978; Miles & Snow, 1978; Porter, 1980). It is beyond the scope of this paper to address the applicability of all strategies in these extant classifications. Instead, we focus on two of the most commonly cited generic strategies: low cost leadership and differentiation (Porter, 1980). We identify the drivers of each generic strategy and discuss whether liabilities of newness or smallness prevent firms from employing them.

**Low Cost Strategic Content.** A low cost leadership strategy is one in which firms derive advantages by having a lower cost structure than their competitors (Hill, 1988). From a survey of the strategic management literature, we have identified four primary drivers which facilitate a low cost structure: 1) economies of scale, 2) economies of learning, 3) economies of scope, and 4) superior technology (Miller, 1988; Murray, 1988; Porter, 1980). We describe each of these drivers and analyze their applicability to new and small ventures.

Economies of scale is a microeconomic concept referring to the reductions in unit cost that accompanies greater size, or increased production (Makadok, 1999). Several factors may account for the decrease in unit cost, including increased purchasing power or spreading fixed costs over higher volumes. Almost by definition, economies of scale-related strategic content is the domain of larger firms for the simple fact that to attain the benefits one must have significant production magnitude. As such, the liability of smallness precludes the use of this strategic focus (Chaganti, 1987; Wright & Parsinia, 1988). The liability of

newness, on the other hand, is not necessarily at odds with economies of scale. For instance, a well-funded new venture (e.g. one with venture capital, or corporate backing) may achieve the size necessary to achieve economies of scope from inception. However, the vast majority of microfirms do not have the benefit of external funding and would therefore not be able to pursue this strategy.

Economies of learning are phenomena whereby incremental production costs decline as production experience is acquired (Yelle, 1979); it is essentially the benefits that arise from 'learning by doing'. Several factors account for the decline in costs associated with task repetition (Gaynor, Seider, & Vogt, 2005). For instance, labor may become more dexterous over time as workers make fewer mistakes, hesitate less, and learn short-cuts in production. Improved efficiencies in technologies may be introduced over time as users understand them better. Standardization of product inputs and production processes may develop as workers and managers learn. Unlike economies of scale, economies of learning strategic content may be available to small firms, but generally not to emerging firms, who may lack the track record, established routines, and relevant experience which contribute to economies of learning.

Whereas economies of scale refer to decreases in cost derived from producing more of a product, economies of scope refers to decreases in costs derived from producing multiple types of products (Helfat & Eisenhardt, 2004). Essentially, economies of scope may be achieved by product-diversified firms. Such firms may reduce costs by spreading the use of resources across product lines. Similar to economies of scale, small firms are not

likely to have the diversity required to achieve economies of scope. While it may be possible for microfirms to offer multiple products or services, diversification into multiple product areas is often something that occurs over time as part of growth. New firms, on the other hand, present an interesting context for diversification. While strategy research generally portrays diversification behavior as the domain of mature firms (Scott, 1971; Quinn & Cameron, 1983), this does not exempt new firms from having multiple products from their inception. However, the ability of a new venture to diversify may also be a function of resource endowments.

Superior technology may also contribute to executing low cost strategies in entrepreneurial ventures. A classic example is the use of new technologies such as electric arc furnaces by mini-mills in the mid 1900's to enter the market cheaply and compete with behemoth competition such as Bethlehem Steel and U.S. Steel (Christensen, 2000). We propose that superior technology is unrelated to the liabilities of newness and smallness. Although researching and developing elaborate technologies may be beyond the reach of most new and small ventures, the adoption of new technologies, particularly those that are affordable, may be accomplished by either. Indeed, many new firms are founded on the basis of unproven technology and many solo entrepreneurs/inventors may develop superior innovations without the benefits of larger organizational endowments or staff (O'Regan & Ghobadian, 2005; Rosa, 1999).

Taken together, our analysis indicates that some of the drivers of low cost leadership strategies apply to new and small ventures, while others do not. Specifically,

economies of scale and economies of scope may not apply to small ventures, but are possible for new ventures. Conversely, economies of learning do not apply to new ventures but are possible for small ventures. Superior technology seems applicable to both new and small ventures.

**Differentiation Strategic Content.** A differentiation strategy is one in which firms derive advantages by making the uniqueness of their products apparent to their consumers. From a survey of the strategic management literature, we identified six primary drivers of differentiation. They are: 1) quality, 2) brand image, 3) customization, 4) speed, 5) convenience, and 6) unique style (Miller, 1988; Murray, 1988; Porter, 1980). We describe each of these drivers and analyze their applicability to new and small ventures.

Of the six drivers of differentiation, four seem fully applicable to both new and small ventures: quality, customization, unique style, and convenience. There is a long history of entrepreneurial firms who entered markets with high quality strategies. For instance, Starbucks was founded with the goal of selling high quality coffee products, Google differentiated itself by producing better results than other search engines, and JetBlue distinguished itself by having both low cost and high quality in-flight amenities for passengers (e.g. a television in every seat). Such examples attest to the fact that new ventures can pursue differentiation through high quality products. Yet microfirms are not precluded from high quality strategies either. Often local fruit stands are considered as having higher quality than grocery stores even though they are significantly smaller. Customization refers to the production of products or offering of services which are specifically

tailored to the preferences of the customer (Dewan, Jing, & Seidmann, 2003). In many ways, customization is more amenable to small firms than large for the simple reason that the latter tend to target a larger customer base and compete on the basis of efficiency; customizing products for all would be a complex and costly undertaking that would suggest competing on flexibility (Ebben & Johnson, 2005). For this reason, differentiation through customization may be an ideal strategy for new firms wishing to carve out a niche in an established market. Firms differentiating themselves through convenience make it easier for customers to purchase their goods and services than the competition, often through close geographic proximity. This is a common differentiator for small and new firms, particularly those selling relatively undifferentiated products or services, such as dry cleaners, gas stations, or liquor stores. Finally, firms differentiating themselves through unique styling provide products with distinctive fashion or design. We have no evidence that either a liability of newness or smallness would limit a firm's ability to engage in unique styling differentiation. In fact, in certain industries, a lack of legitimacy may be an advantage for certain entrepreneurial design firms if the founders are not seen as being part of 'the establishment.' Taken together, we believe that extant research on differentiation via quality, customization, convenience, and unique styling are applicable to both new and small ventures. Conversely, we argue that differentiation via brand image and speed may be limited by liabilities of newness and smallness, respectively.

A brand image is the impression in the consumer's mind of the qualities and shortcomings associated with the brand (Kunde, 2002). Thus, even though a firm's

product may be similar to that of competitors, the brand image may differentiate them. Pertinent to the present study, brands are developed over time through consumers' experiences with products bearing the brand and through advertising campaigns (Kunde, 2002). Because it takes time and oftentimes substantial resources to develop brand images, this route to differentiation is unavailable while firms endure a liability of newness.

Speed refers to the ability of a firm to consistently be first to market with new products or services. Achieving continual innovation and speedy product introductions generally requires significant research and development investments. As such, we believe that the liability of smallness could limit the ability of entrepreneurs from utilizing a speed-based differentiation strategy. Specifically, microfirms may have limited resources to devote towards research and development of new products, and therefore not be able to expeditiously create and launch new products. However, there is evidence that small firms may actually be better at using speed to their advantage as they lack many of the core rigidities and structures that may bog down the response time to pursue opportunities. For instance, Chen and Hambrick (1995) found that many small firms were able to compete by sequencing quickly scheduled competitive moves. As microfirms have fewer employees and decision-making often by one individual, there are likely to be fewer barriers to quick decisions.

In sum, while new and small firms may be able to differentiate themselves via quality, customization, convenience, and unique styling, we argue that they are limited in

differentiating themselves via brand image and speed.

### **STRATEGIC ASSETS AND CAPABILITIES**

Strategy scholars as early as Penrose (1959) have focused on how internal firm capabilities effect the growth and performance of firms. The Resource-Based View (RBV) codified a theoretical approach to treating the firm as a collection of resources (Wernerfelt, 1984), which can be exploited for a competitive advantage (Barney, 1991). Resources are comprised of a diverse set of tangible and intangible resources (e.g. financial, social, human and physical). Their usefulness stems from their valuable, rare, inimitable and non-substitutable characteristics, and from their heterogeneous configurations within individuals firms (Barney, 1991). While initially an area of study within large and established firms, the possession and usage of resources has been shown to be important in new and small firms as well (Alvarez & Busenitz, 2001). Resources such as human and social capital (Wiklund & Shepherd, 2008), financial capital (Zellweger, 2007) and reputation (Sieger, Zellweger, Nason & Clinton, 2011) have been linked to entrepreneurial behavior. In the context of new and very small ventures, the resources of the founder may also be the resources of the firm. As such, it may be difficult to separate the individual from the firm.

The liabilities of newness (Stinchcombe, 1965) and smallness (Freeman, Carrol & Hannan, 1983) can both be viewed from a resource and capability perspective. Specifically, the theories argue that new and small firms lack legitimacy and face difficulty creating a track record, and thus have a much lower survival rate than

established firms. The lack of legitimacy (itself an intangible resource) creates difficulties for new and small firms in acquiring other rare and valuable resources, such as financing and employees, which are necessary for survival and growth. As such, this view of possessing key assets and being able to deploy them in the pursuit of competitive advantage seem especially germane for very young firms and microenterprises.

A traditional perspective of resources may assume that the accumulation of more valuable and rare resources will necessarily lead to a competitive advantage, thus rendering small firms who control fewer resources at a tremendous competitive disadvantage. This rather simplistic 'bigger is better' view in theorizing is quite common in RBV literature (e.g. Unger et al., 2009); however, recent empirical results in these research streams show that oftentimes less is better (Christensen, 1997; Bradley, Wiklund & Shepherd, 2011). Bradley and colleagues (2011) demonstrate that while slack (excess resources) has a positive overall effect on growth, it has a negative effect on entrepreneurial management, which in turn has a positive impact on growth. This provides a more nuanced view to RBV and suggests that the size of a firm's resource endowments may not always have a clear direct positive benefit to firm performance. Thus, while larger organizations may have greater absolute stocks of resources, they may face more significant challenges in the structuring, bundling and leveraging of those firm resources due to their more complex structure and administrative processes (Sirmon, Hitt, & Ireland, 2007). For instance, large and small organizations in the knowledge-based economy both engage in strategies aimed at generating critical knowledge based resources. Large

firms may be able to do this more quickly, for instance, through purchasing and investing in small firms. Smaller firms, as they often lack the financial capital to purchase firms or the managerial capacity to integrate post-purchase (McKelvie & Wiklund, 2010), have to rely on the longer process of organically growing through internal projects. However, given the less complex structure, smaller firms may be able to better internalize and apply this learning than larger, more diverse firms (Hoang & Rothaermel, 2005).

Small and micro-firms in the knowledge-based economy may also be able to access different types of resources and in amounts disproportionate to their size. For instance, firms with relatively few employees can gain access to valuable resources through social networks (Nahapiet & Goshal, 1998). In addition, firms with few assets can also accumulate valuable reputation resources through recognition by the popular press and media. By developing a large network or significant reputation, microenterprises can gain access to a larger pool of resources which can be exploited for competitive advantage and growth.

New firms face a strategic asset challenge in that they may not have a codified firm level bundle of resources. Research on the use of effectuation in the entrepreneurial process (Sarasvathy, 2001) has emphasized the way in which entrepreneurs use their individual collection of resources and the resources in their network to shape entrepreneurial opportunity and eventually transfer these resources into the firm. Such an approach, while divergent from a traditional firm level strategic asset approach (e.g. Barney, 1991) may be more appropriate for microfirms and emerging enterprises. Small and microenterprises may be similar to family firms in that there

is a flow of resources between the firm level and the external individual (or family) level (Sharma, 2008).

Not only do small and microfirms have the potential to expand the boundary conditions of resource-based theory by broadening the level of analysis, but the process that solo and emerging entrepreneurs use to identify and collect resources has the potential to shed light on the micro-foundations of resource-based theory (Barney, Ketchen, & Wright, 2011). In fact, the heterogeneous nature of human capital capabilities is an underlying mechanism for capabilities in general (Foss, 2011) and further study of the human capital of solo entrepreneurs may help enrich this important dimension.

Clearly, access to and control of valuable, rare, inimitable and non-substitutable strategic resources is a critical challenge for new and small firms. The ability of small and microfirms to gain access to and leverage these resources will be a determinant of their ability to survive and eventually grow. However, small and microenterprises in the knowledge-based economy may actually be better suited to overcome the liabilities of newness and smallness than in the era of the industrial corporation. While small firms and microenterprises may not directly control as many valuable resources, an increasingly inter-connected world gives firms easier access to valuable and rare resources. New strategies such as joint-ventures, outsourcing (Tsang, 2002) and virtual teams (Montoya-Weiss, Massey & Song, 2001) allow new and small firms to access a disproportionate amount of resources than their size would have previously allowed. The resource-based processes at work in small and emerging firms will surely prove to be a valuable area of future research.

## **STRATEGIC PROCESSES**

Strategic processes are distinct from strategic content, strategic resources, and strategic analysis. Strategic processes are more in line with “how” strategy is executed whereas strategic content is more concerned with the “what” (Bourgeois, 1980), and strategic analysis may be seen as the “why” used in helping to determine the strategic content. To that end, strategic processes capture issues such as the mindset of the firm and its decision-making processes (Dess & Lumpkin, 2001) that help the firm to enact its purpose or carry out its vision (Hart, 1992). This might include the continued attempts to determine opportunities and threats and ensuring that the firm is correctly positioned in the market in order to achieve its goals (Shrivastava, 1983).

Much of the work on strategic processes has focused on the elements or dimensions of strategy making (Rajagopalan, Rasheed & Datta, 1993). Early work conducted on large firms began to address the modes or dimensions that firms displayed. For example, Mintzberg’s work (1973; 1978) examined such factors as the planning mode that was characterized by formal analysis, the adaptive mode of strategizing that took stakeholder concerns into consideration, and the entrepreneurial mode that included opportunity-seeking behaviors and risk-taking. In turn, Mintzberg’s research was influential in subsequent work into the strategy-making dimensions that showed that three common dimensions of strategic processes were common to entrepreneurial firms: innovativeness, proactiveness, and risk-taking (Miller, 1983). These three dimensions have now become to be widely viewed as the key components of a firm’s Entrepreneurial Orientation (EO) (Covin & Slevin, 1989).

There have been over 100 empirical studies that have examined the relationship between EO and firm performance (Rauch, Wiklund, Lumpkin & Frese, 2009). Among these, EO appears to be especially important for understanding firm level outcomes for small firms (Wiklund, 1999) as it helps to provide insight into how the mindset of continuing to grow and seek opportunities is carried out over time. Interestingly, the strength of the relationship between EO and firm performance is actually higher for microfirms than for firms of any other size firm (Rauch, Wiklund, Lumpkin & Frese, 2009). The logic behind this is that, for the smallest of firms, top managers have additional ability and power to influence the overall direction of the firm as there is less reliance on others within the firm (i.e. middle managers, employees). In other words, EO is likely to best be carried out within microfirms in line with management's aspirations.

Yet, although EO is more important for smaller firms, there appear to be an important number of considerations that may affect microfirms ability to display such an orientation. For instance, carrying out EO activities are extremely resource consuming and oftentimes require substantial resource investments (Covin, 1991). Further, the influence of EO is the highest when organizational structures are in place to help manage EO and firm decisions (Green, Covin, & Slevin, 2008). As such, even if microenterprises may desire the pursuit of an EO, they may struggle with implementing these strategic processes on account of a lack of significant resource endowments and developing organizational structures. Simply put, even displaying an EO may not be possible for micro- and emerging firms given a lack of resources and routines.

While certainly providing challenges for new and small firms, the empirical finding that EO is highly correlated with the performance of smaller firms means that some firms are able to meet these challenges. Yet, it appears as though there may be a tradeoff or difficult balancing act needed for these firms. For instance, there is an important trade-off in regards to the EO component of risk-taking. Risk-taking involves committing resources to endeavors whose outcomes are uncertain. Given a lack of slack resources, new and small firms may need to engage in calculated risk-taking in order to gain control over important resources (Pfeffer & Salanick, 1978). Acquiring these resources may help these firms fuel future prosperity due to continuous investments into growth. Yet, since the outcomes of risky endeavors are unknown in advance, there is certainly no guarantee that these risks will pay off. As new and small firms are not likely to possess a resource buffer to sustain potential losses due to unprofitable risks, many of these firms are not likely to survive as a result (Wiklund & Shepherd, 2011). Consequentially, many new and small firms may succumb to their liabilities, whereas older and larger firms may survive as they have more likely acquired larger resource bases from which they can sustain some risky losses.

A similar argument can be made for the difficult balancing act of innovativeness. Many new and small firms are encouraged to develop novel products or services offerings. Indeed a core strength that is often attributed to new and small firms is their ability to provide radically different innovations that truly alter an industry (Leifer et al., 2000; Christensen, 1997). Further, there is some research that shows that the capability to innovate tends to decrease as a venture ages (Thornhill &

Amit, 2003). As firms age, they tend to develop innovations that are more closely in line with their existing market offerings and building upon their existing capabilities (Sorensen & Stuart, 2000). Older and larger firms may also have to deal with core rigidities, the need to balance the needs of multiple stakeholders, and organizational politics that may prevent firms from carrying out framebreaking work (Baker & Cullen, 1993).

Yet, while this speaks to the potential to innovate for micro- and new firms, there is also the challenge of gaining legitimacy. New and small firms are known to lack legitimacy and oftentimes are dismissed as not being 'serious' firms if they do not conform to the established industry norms and methods. Firms that are 'too innovative' compared to industry norms or exemplars may not be seen as legitimate and may therefore be ignored by the market as compared to the offerings of more established firms (Aldrich & Auster, 1986). Within industries, there is often a push by the major players to set standards and norms, in line with isomorphic pressures (DiMaggio & Powell, 1983; Meyer & Scott, 1983). As such, there appears to be an additional external legitimacy concern for new and small firms as it concerns their level of innovativeness.

Together, these issues show a precarious situation for those firms who are very new and very small. There appears to be an important balancing act in the strategic processes of these firms, where these firms need to carefully weigh the areas of risk-taking and innovativeness with an eye to both fitting in with established norms, yet also standing out in order to earn financial returns. As such, there is a tradeoff in dedicating resources and processes related

to implementing entrepreneurial strategic processes.

## **DISCUSSION**

In this paper, we have addressed the question of whether strategy is different for new and very small firms. In short, we answer yes, but also present a number of non-obvious reasons. In discussing four major components of strategic management (strategic analysis, strategy content, strategic assets/capabilities and strategic processes), we explore the impact of the liabilities of smallness and newness. We outline many of these issues in Table 1. At first glance, these liabilities would appear to be unduly negative, and thus constitute a strategic management-based logic as to why firms in this size and age class have a higher mortality rate than others (Stinchcombe, 1965; Freeman, et. al., 1983). Reasons that would be particularly relevant include that new and small firms, almost by definition, have lower stocks of valuable resources that are critical for growth (Barney, 1991), they lack legitimacy which creates challenges in acquiring those critical resources such as financing and new employees, and that they lack bargaining power in relation to suppliers (Dobrev & Carroll, 2003). The result of these issues is that microfirms and emerging enterprises may be seriously hindered in certain areas of strategic management, including creating challenges in establishing low-cost economies of scale strategies or differentiated strategies based on brand or speed. However, once a strategy is chosen, small and new firms may face an inability to implement them. Strategic processes, such as entrepreneurial orientation, consume a significant amount of resources, which are often scarce within new and small firms. As a result, well intentioned strategic processes may be faulty, incomplete or ineffective.

**Table 1: Mapping the impacts of newness and smallness on strategy**

	<b>The impact of newness</b>	<b>The impact of smallness</b>
Strategic Analysis SWOT Analysis 5-Forces Analysis Value Chain Analysis	Lack of power over supplies and customers may force firms into precarious competitive positions View of locally defined competitors and niche customers may constrain analyses	May lack ability to conduct traditional analyses due to a lack of core strengths or weaknesses Unable to provide full set of activities due to lack of human capital
Strategic Content Cost Leadership vs Differentiation	New firms lack the experience to derive cost benefits from economies of learning The lack of a track record prevents new firms from differentiating themselves through brand image	Smallness runs contrary to economies of scale and scope, limiting the ability of small firms to derive cost advantages. Limited resources in small firms inhibit a firm’s capacity to continually be first to market.
Strategic Assets/Capabilities Resource-Based View	Lack of legitimacy creates challenges in acquiring other valuable resources Lack of firm level resources creates a greater reliance on individual and firm external resources	Lower stock of valuable resources Greater flexibility in the ability to manage resources
Strategic Processes Entrepreneurial Orientation	New firms lack legitimacy and therefore may force them to follow industry norms Lack of track record may allow them to be more innovative	Risk-taking is balancing act to ensure survival Lack of core rigidities and structures allow to quickly react and be proactive in pursuing opportunities Innovative launches oftentimes require major resource outlays

However, this bleak picture may not tell the whole story. Practically, we know that many firms overcome the liabilities of newness and smallness and go on to become the next generation of dominant players. It was only a few years ago that Google, Facebook and Amazon were just interesting words on the pages of a business plan. Empirically, we know that frame

breaking entrepreneurial activity is often prevalent in young, small firms and that these firms can play a disruptive role in entire industries (Schumpeter, 1942; Hockerts & Wustenhagen, 2010). We suggest that small firms may also benefit from certain strategic advantages. As it concerns strategic analysis, small and micro firms may be able to succeed in niches

which may initially appear unattractive for larger players. Given the strong emphasis placed on business planning in many new ventures (Delmar & Shane, 2003), they may be more likely to think critically about the competitive landscape and put to use strategic analysis tools in ways which large firms with entrenched routines and strong path-dependences may not (Baker & Cullen, 1993). Newness and smallness may also allow firms to employ strategies that established firms simply cannot. For instance, a new and small firm may be able to more successfully differentiate itself in a way that is against the industry norms, while established players who have helped to define the norm would be unable to replicate this approach. While new and small firms almost certainly have less stocks of resources than large established firms, they may also possess less complex structures (Blau, 1970) and core rigidities, which in turn may allow them to more effectively deploy and manage their resources (Sirmon et al, 2007). Indeed there is evidence that smaller firms may be able to better apply knowledge resources than large diverse firms (Hoang & Rothaermel, 2005) and may be able to more quickly pursue subsequent opportunities (Chen & Hambrick, 1995). As such, the liabilities of newness and smallness can actually lead to greater advantages in new and small firms.

In addition to negative and positive effects of newness and smallness, there may simply be differences in the strategy of large and small firms. We have largely reviewed small business strategy through established theoretical lenses developed within the context of large firms; however, there may be ways in which new and small firms follow different rules of the game entirely. The emerging theoretical and empirical evidence from studies on effectuation

(Sarasvathy, 2001) show that entrepreneurs think and act in ways that are contrary to dominant mental models in traditional corporations (Chandler et al., 2011). According to an effectual approach, entrepreneurs often employ a creation or effectual logic which focuses on how to create value out of existing resources within the context of uncertain environments, which could include a heavier reliance on strategic partnerships. This is contrary to the causal logic prevalent in the strategic planning of large firms which attempt to predict an optimal decision based on a set of assumptions. Similarly, new and small firms may be more likely to engage in intuitive and informal strategic processes while large established firms may be more likely to use formal strategic planning (Allred, Adams & Chakraborty, 2007). Further, many new firms and microenterprises need to rely on bootstrapping in order to overcome a lack of resources (Winborg & Landstrom, 2011). This may promote entrepreneurial thinking such as making do with what is at hand as opposed to planning grandiose financing plans. Both strategies have advantages and disadvantages and the use of each may be better suited for their particular context.

**Implications for new entry.** In our discussion, we have frequently alternated between young firms and small firms and their related management issues. One of the potential advantages that we attributed to the liabilities of newness and smallness was an ability to pursue subsequent opportunities due to fewer sunk costs and core rigidities. While the initial entry of a microfirm into a market is the focus of many important streams of literature, there is less attention paid to subsequent strategic changes, such as expansion into new markets, and launching of new products or services. Lumpkin and Dess (1996) refer to

these activities as new entry<sup>1</sup>, which they describe as the essential act of entrepreneurship.

One of the key ideas brought up in our discussion of microfirm strategy was that of focusing on a well-defined niche market. In many cases, this comes in the form of a very specific (local) geographic area, such as an individual street or a particular neighborhood. One advantage of this approach is avoiding having to face larger competitors head on, as larger firms may ignore smaller niches, or attend to more heavily populated geographic markets. Consider the distinction in focus of a street hot dog vendor versus a fast food restaurant such as McDonald's. There appear to be a number of important considerations with regard to subsequent new entry related to the liabilities of newness and smallness. For instance, many niched firms may enter a parallel or geographically proximal new market, such as one block over from their current location. Yet these young and small firms may face persistent liabilities of newness and smallness even when they enter these nearby markets because internal conditions are different and they may be dealing with new customers. That is, even though their internal liabilities (routines, organizing) may have become established

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<sup>1</sup> New entry can also consist of the development of new organizations. However, this mode of new entry is very uncommon for new and very small firms, who lack the organizational structures to successfully manage this. Instead, an alternative approach to this might be seen as new projects or independent new firms started by an entrepreneur. This portfolio approach to owning multiple firms is common but moves our discussion from being at the firm-level to that of the individual level.

in their original location, they may have little reputation or legitimacy to draw on in the new location. As such, there may be discrete activities that new and small firms may need to enact in order to convince external stakeholders that they are legitimate. While this new entry may seem miniscule from a large firm perspective or the impact of small firms on the economy, the risks involved may be very large for the microenterprise.

There are similar effects for the new product or new service new entry as well. If a microfirm needs to develop new relationships with suppliers or distributors as part of diversification, then it may face issues of supplier power again. There is currently little research as to how to transfer legitimacy from one industry to the next, and therefore how legitimacy and reputation play a role in subsequent new entry.

An important aspect of future new entry research is to better understand how these liabilities are affected in a knowledge-based and networked economy. One strategy that many new and small firms engage in is to develop relationships with others to overcome individual resource shortages. Yet, in the current economy where joint ventures, alliances, and virtual teams are commonplace, there is a blurring as to where the lines of an organization are drawn. Individual small firms may be seen as moving parts in a machine, with fewer physical investments and a reliance on knowledge capital. In such increasingly complex network structures or clusters of firms where entrepreneurs work together to provide individual know-how to a particular task at hand, knowing what a singular firm does itself and what it does via others may provide a challenge in understanding the strategic management of these firms.

In a related area, one of the motivations behind this paper was to better understand how the liabilities of newness and smallness affect the strategic management of microfirms and emerging enterprises. For many firms, the goals of the founder are paramount. Yet, prior statistics suggest that these firms also have a higher likelihood of exit and suggest that many of the founders' goals are not met. From a new entry perspective, the question becomes what happens to these entrepreneurs? Do they re-enter the market with different business models, strategies, and products/services in order to try their luck again? If so, how much do they alter their strategies as part of this re-entry? Or do these individuals pursue other options, such as traditional employment or unemployment insurance? There may be some national culture and political structure issues that may help define the options of these individuals, but the point nonetheless is what new entry approaches do these individuals take, if any?

**Implications for research.** There are several topics related to our analysis which we believe represent fruitful opportunities for future research. First, this paper investigated the applicability of four components of strategy common in the strategic management literature to new and small ventures: strategic analysis, content, assets/capabilities, and processes. We discussed and applied a select number of theories and perspective only to the extent that they informed these relationships. However, future research may make the applicability of theories common in strategic management to new and small ventures a focal point. A comprehensive discussion of how theories such as agency theory, stewardship theory, resource dependence theory, upper echelon theory, prospect theory, or diffusion theory

manifest themselves differently in new and small ventures may provide a useful resource for strategic entrepreneurship scholars.

Second, while the four components we investigated may account for a large portion of strategic management activity, we were limited in our ability to comprehensively address each component. For example, the bulk of our evaluation of strategic content concerned low cost leadership and differentiation. Yet other facets of strategic content include issues such as organizational simplicity (Lumpkin & Dess, 1995; Miller, 1993) or the structure and controls used by an organization (Keats & O'Neill, 2001; Tempel & Walgenbach, 2007). An analysis similar to the one conducted in this paper upon such omitted facets of strategic analysis, content, assets/capabilities, and processes by future scholars would provide a more complete understanding of the relationship between liabilities of smallness and newness, and strategy.

Third, we essentially treated the smallness and newness of a firm as dichotomous – firms are either small or not; new or not. Yet size and maturity are continuous firm characteristics. We have identified in this paper many findings from traditional strategy research that do not necessarily apply to young and new ventures. However, while scholars attempt to classify them, firms are generally not small or new one day and large or mature the next. For most, the progression is gradual with few obvious demarcations. As part of this, organizations have begun to adopt a number of organizational forms to either 'act big' in the case of smaller firms that exude substantial power or also 'act small' in the case of larger firms attempting to circumvent organizational structural

constraints and politics in order to emulate smaller, more entrepreneurial firms. Thus, taking an evolutionary perspective on the relationship between smallness, newness, and strategic components may represent an opportunity for future work on the subject.

Fourth, there is an important linkage between the firm and individual levels of analysis. For many microenterprises and new firms, the founder is also the most important employee and driving factor behind all of the strategic actions of the firm. As such, although we have discussed a potential lack of knowledge or legitimacy on behalf of the firm, the founders' human capital and previous industry experience may in fact confer a large amount of knowledge and legitimacy upon the firm if the founder is someone with superior talent and reputation. One important area of interest in future is therefore in trying to understand how individual level (or team level) strengths or weaknesses play into the strategic management of the firm, and at what stage of firm development (age or size) does the reliance upon a key individual change.

**Limitations.** In this review, we have addressed very small and new firms rather generally; however, it is important to recognize that the population of small and new firms is extremely heterogeneous. Within these broad classifications of firms, there may be a myriad of ways in which these firms implement strategy. For instance, the founding resources of the firm may have a substantial impact on its subsequent trajectory. Among the most obvious of these resources is the impact of financing on strategic decisions. For instance, an early stage venture that receives venture capital investment or the financial support of a parent firm will have a completely different resource endowment

– not only financially, but also the access to expertise and networks. This resource base has implications not only for which initial strategies they choose to implement, but also their effectiveness in resource consuming strategic processes such as EO. Perhaps more pertinent is that the receipt of such investment speaks to the growth potential of the firm and its initial product/service, and therefore the human and social capital of the founder or founding team. However, while we have attempted to discuss microfirms and new ventures as being autonomous and independent, we acknowledge that the founding resources of the firms will also affect their strategy. We believe that those firms receiving external capital are more likely to pursue strategies in line with the 'large firm' strategic management literature.

Further research to understand strategy in very small firms should also examine the heterogeneous nature of small firms themselves. Some important work has been done, for instance, identifying opportunity vs. necessity entrepreneurs (GEM Global Report, 2011), growth oriented versus small business oriented firms (Wiklund, Davidsson & Delmar, 2003), gazelles (Henrekson & Johansson, 2010), and microenterprises (De Jong & Marsili, 2006). However, much further work is needed to identify the dimensions, such as goals, growth orientation, resources, and formality, which differentiate small firms from each other and how these dimensions may impact strategy.

## CONCLUSIONS

In this paper, we have argued that the majority of work in strategic management has adopted tools, concepts and processes that have been applied in the context of large, established firms. While there is a

rich literature on small business strategy, even these studies have tended to adopt the perspectives of the broader management literature. We suggest that there are potentially rich areas of research by examining the effects of liabilities of newness and smallness on the most common firms in our economy: very small and very new firms.

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