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THE SMALL BUSINESS SCREEN: A WAY TO EVALUATE SMALL BUSINESS OPPORTUNITIES

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ABSTRACT

A Small Business Screen is developed which prospective small business owners can use to screen business opportunities according to market attractiveness and their ability to compete. Assessments of market attractiveness and ability to compete are used to plot the position of each proposed business. The resulting plot shows which businesses are likely to succeed and which are likely to fail. The Small Business Screen is a logical extension of the concepts used to develop the General Electric/McKinsey industry attractiveness-business strength screen. Its use should prevent many prospective small business owners from entering businesses in which they are almost certain to fail.

Studies show that small businesses which use strategic planning perform significantly better than ones that do not (Ackelsberg & Arlow, 1985; Bracker & Pearson, 1986; Bracker, Keats & Pearson, 1988). However, few small businesses use strategic planning, and even then they are not likely to use it consistently (Sexton & Van Auken, 1985; Shrader, Mumford & Blackburn, 1989). Twenty-five years ago George Steiner (1967) found small businesses were unlikely to engage in strategic planning because "it's for big companies, not for me," or "it's too complicated."

Steiner's findings are just as pertinent today. Strategic planning models have been primarily developed by, and for, large firms, and they can be complicated and time-consuming to use. In the 1970s a substantial amount of work was done developing matrix-based strategic planning models to help large firms determine which businesses they should be in. The best known of these models are the Boston Consulting Group (BCG) growth-share matrix and the General Electric (GE)/McKinsey industry attractiveness-business strength screen.[1] Although conceptually similar, the GE model differs from the BCG model in that the GE model uses several factors to make up its horizontal and vertical axes (a multi-factor assessment), while the BCG model uses only one factor on each axis. Many sources document in detail how these models were developed, how they should be used, and their shortcomings (e.g., Day, 1977; Hall, 1978; Hax & Majluf, 1983, 1984; Hedley, 1977; Hofer & Schendel, 1978; Walker, 1984).

Small businesses have historically made almost no use of such models. However, small businesses have an even greater incentive to review and evaluate strategic alternatives (business opportunities) than do large firms. Due to their smaller resource bases, small businesses can usually choose only one business in which to compete. A single poor decision can be fatal.

Fortunately, it is possible to develop a Small Business Screen, similar to the GE/McKinsey industry attractiveness-business strength screen, which can be used by prospective small business owners to assess their chances of success before they enter a particular business. Use of this simple strategic planning tool should prevent many people from entering businesses in which they are almost certain to fail.

THE SMALL BUSINESS SCREEN

The Small Business Screen is shown in Figure 1. The vertical axis is labled *market attractiveness* and the horizontal axis *ability to compete*. The purpose of the screen is to show how well internal capabilities (ability to compete) match up with external factors (market attractiveness). Internal capabilities are usually under control of the owner, while, with one major exception, external factors are usually not controllable by the owner. The major exception is that small retail and service businesses can usually change their location without difficulty and, in so doing, can often change their market. Since large businesses usually have regional or national markets, they rarely have this capability.

USING THE SMALL BUSINESS SCREEN

Here is how to use the Small Business Screen.

Step 1: Select the Business to Analyze

The business to be analyzed may be either a potential new business or an existing business. Many people become small business owners by buying an existing business rather than starting a new one. When this is the case, the business under consideration for purchase would be analyzed.

Step 2: Assess Market Attractiveness

To assess market attractiveness, it is first necessary to identify the factors that comprise market attractiveness. While these factors can vary with different businesses, the following should apply to most situations: size of the local market, local market growth rate, labor supply (skills and wage rates), local demographics, and the number and relative strength of competitors.

The factors can be evaluated by two methods. The first method is the more quantitative of the two. Each factor is graded on a five point scale such as the following:

1 – Very unattractive

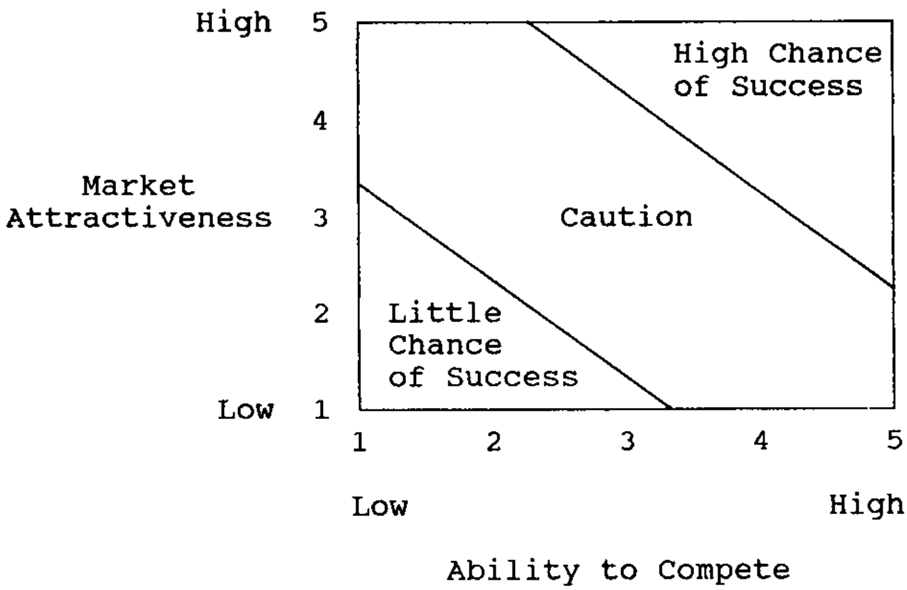
2 – Mildly unattractive

3 N Neutral

4 + Mildly attractive

5 + + Very attractive

Figure 1. The small business screen.



The average of the scores for all factors gives a numerical value for market attractiveness. If the factors are given weights, then a weighted average can be found for market attractiveness. The result is a measure of market attractiveness which ranges from one (low) to five (high).

However, a word of caution is in order. When a numerical value for market attractiveness is calculated in this manner, it appears to be much more accurate than it really is. There is always some subjectivity associated with the selection and evaluation of the factors used to assess market attractiveness. Thus the value obtained should be considered an approximation of the actual value rather than the actual value itself.

Furthermore, it is generally assumed that the values of the factors are additive and that no value can constitute more than a certain percentage of the final value. In practice this may not be the case. A low value of one factor such as a weak local economy may be enough to negate high values on the other factors.

The second method explicitly recognizes the subjective nature of selecting and evaluating individual factors. Instead of attempting to put a precise quantitative measure on each factor, the prospective owner together with his or her advisors identifies the most important factors relating to market success. Each factor is then discussed and evaluated in general terms. After this has been completed, external events are considered that may be relevant to the analysis such as an announcement that a long-time local competitor is going out of business. Loss of a competitor would probably improve market attractiveness if it was due to retirement of the owner. On the other hand, it would probably reduce market attractiveness if it was due to severe local competition. After all factors and their interactions have been considered, market attractiveness is assigned a numerical value for purposes of plotting on the Small Business Matrix. Again, the range is from one (low) to five (high), and the value is an approximation of the actual value. The most important reasons leading to the final evaluation should also be written down for future reference.

At first glance it may not appear that much data are available to facilitate making assessments concerning the attractiveness of a local market. However, local Chambers of Commerce and state Departments of Commerce will often provide extensive data on a particular community free of charge. Trade associations are an invaluable source of information on an industry. A comprehensive listing of associations including trade associations can be found in the current edition of the *Encyclopedia of Associations* (Burek), available in most public libraries.

Step 3: Assess Ability to Compete

Ability to compete is closely related to the strategy a small business selects. Using the framework developed by Porter (1985; 1991), a business can select one of three strategies and related ways to compete: low price, differentiation of products or services, or filling a niche. Competing on low price is difficult for most small businesses, since it implies high volume, mass production of an undifferentiated product, rapid inventory turnover, and low margins. Jan Bell Marketing is an example of a business that successfully competed on price from the time it was started in 1983 (Brown, 1990). Jan Bell distributes large volumes of private label jewelry to wholesale clubs such as Pace and Sam's for about a third of what other manufacturers charge. However, most small businesses are better suited to compete on the basis of differentiation or filling a niche than on the basis of price.

Differentiation refers to adding features to a standard product or service to meet the specific needs of one or more customers, usually for some premium in price. Niche products fill a specific need. Often many businesses need the products such as office supplies or packaging materials, but the volume is insufficient to be attractive to a large firm. Differentiation and niche strategies require special skills in marketing and production to allow for modifications of existing products or to respond quickly to changes in the nature of volume or demand.

Ideally, the firm's internal skills in each major functional area should be consistent with the basis of competition it has chosen. Evaluation of internal skills is often less subjective than evaluation of market attractiveness because comparisons can be made against the skills of the strongest competitor. A five point scale such as the following can be used to develop an initial value of ability to compete.

1 – Large competitive disadvantage
2 – Small competitive disadvantage
3 N Neutral; about equal
4 + Small competitive advantage
5 + + Large competitive advantage

This initial value should then be factored up or down as appropriate to take into account important intangible factors such as the commitment of the owner or owners to the business. For example, small businesses are much more likely to fail when their owners are not personally involved in them than when they are (Beam and Carey, 1989). Thus a business that would otherwise plot in the high chance of success portion of the Small Business Matrix will probably fail if its owner does not want to become personally involved in running it.

Step 4: Plot the Factors on the Screen

The numerical values obtained for market attractiveness and ability to compete are used to plot the business's position on the Small Business Screen. A business that plots in the upper right corner should have an excellent chance of success, while one that plots in the lower left corner should have little chance of success. A business that plots in the diagonal area from upper left to lower right should be avoided *unless* the prospective owner is confident he or she can improve or overcome the factors that caused the overall assessment to fall in the questionable region.

A Demonstration: Starting an Ethnic Restaurant

To see how the Small Business Screen works in practice, assume a typical small business start-up situation where a couple is considering starting an ethnic restaurant. For purposes of demonstration, only four types will be considered: Chinese, French, Italian or Mexican food.[3] Figure 2 illustrates how the couple might assess market attractiveness and its ability to compete for each type of restaurant under consideration. Market attractiveness has been assessed using the second, less quantitative method described in Step 2. These assessments are plotted on the Small Business Screen as shown in Figure 3.

The most promising alternative is the French restaurant. The local market is attractive due to the large number of executives and professionals in the area who can afford to eat at a French restaurant. In addition, there is no French restaurant in the area. Ability to compete is also high since one of the prospective business owners is an accomplished French chef.

The least promising alternative is a Chinese restaurant. The local Chinese population is small, and the only Chinese restaurant in the area closed a year ago due to lack of business. Also, neither of the small business owners knows how to prepare Chinese food.

The Italian restaurant plots well on market attractiveness but not on ability to compete. To make a success of an Italian restaurant, the couple would have to find a good chef and become more interested in Italian food. The situation with the Mexican restaurant is just the opposite. Here the couple knows how to prepare Mexican food, but would have to work hard to make Mexican food more appealing to the local population. The couple could probably make a success of either the Italian or the Mexican restaurant if they wanted to. However, given the local market and the couple's personal skills and interests, the French restaurant has a much higher chance of success. The optimal choice might be different if the couple had different culinary skills, or if the restaurant were located in a city with a different demographic makeup.

This simple example shows how prospective small business owners should screen business opportunities before investing in them. Unfortunately, few prospective small business owners take the time to do this sort of analysis. As a result, the failure rate for new small businesses remains very high.

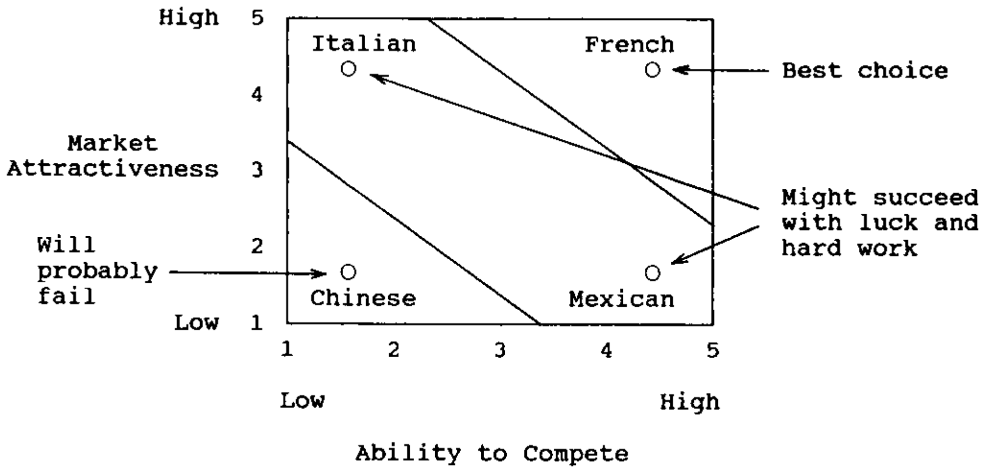
REASSESSING A CURRENT BUSINESS

The Small Business Screen can be as useful to those already in business as it is to those starting a business. It can help identify why a business is not doing as well as it should be doing. Usually the remedy is to attempt to increase a firm's rating either on industry attractiveness or on ability to compete.

Figure 2. Sample assessment of market attractiveness and ability to compete for four types of restaurants.

Type of restaurant	Market attractiveness	Reasons	Ability to compete	Reasons
French	High (4.5)	There are many executives and professionals in the area who can afford more expensive meals. Local residents often travel to a neighboring city to eat at its French restaurant. There is no French restaurant nearby.	High (4.5)	One owner is a skilled French chef. Owners can increase profits by doing their own cooking. Owners enjoy preparing French food.
Italian	High (4.5)	There is a large Local Italian population. The largest Italian restaurant in the area is expanding.	Low (1.5	Owners do not like Italian food. It is hard to find a good chef.
Mexican	Low (1.5)	Mexican food is not popular in this part of the country. A national fast food chain already offers inexpensive Mexican food at two local outlets.	High (4.5)	Owners can increase profits by doing their own cooking. Owners have lived in the southwest and like Mexican food.
Chinese	Low (1.5)	The local Chinese population is small. The only Chinese restaurant in the area closed last year.	Low (1.5)	Owners lack expertise in preparing Chinese food. It is hard to find a good chef.

Figure 3. A demonstration of the Small Business Screen: Selecting a type of restaurant.



Improving Market Attractiveness

The owner of the largest bookstore in a midwestern city initially located downtown, where his primary market was lunch time browsers who bought more nick-knacks and calendars than books. A few years ago he moved from downtown to a location between two malls. His bookstore now attracted customers throughout the day and on weekends. Just as important, the dollar value of the average purchase nearly doubled. His ability to compete (internal skills) did not change at all since his staff remained the same. However, the new location greatly increased the attractiveness of his local market. In fact, one of the great advantages of small businesses, especially retail and service ones, is the ability to improve the attractiveness of the local market simply by changing location.

Improving Ability to Compete

For several years a small printing company strove to increase sales and utilize its equipment more fully by competing on price, a least cost strategy. Sales did increase, but profits remained flat. When the firm examined its distinctive competencies more closely, it found it could use a differentiation strategy by filling many small custom orders more quickly than its competitors. Both sales growth and machine utilization decreased, but the most important measure of success, profitability, increased. The firm's ability to compete increased greatly when it shifted to a differentiation strategy from its original low cost strategy. Internal skills such as production scheduling and cost control could now be used to full advantage.

CONCLUSION

The Small Business Screen is a logical extension of the concepts behind the BCG growth-share matrix and the GE/McKinsey industry attractiveness-business strength screen. In the Small Business Screen, the horizontal axis becomes Ability to Compete while the vertical axis becomes Market Attractiveness. The assessments of market attractiveness and ability to compete are used to plot the position of each proposed business on the Small Business Screen. The resulting plot shows which businesses are likely to succeed and which are likely to fail. Costly mistakes can be avoided by not entering businesses which have very little chance of success according to their position on the Small Business Screen.

Footnotes

[1]The General Electric/McKinsey industry attractiveness-business strength model was developed by GE with the assistance of the management consulting firm of McKinsey & Company. Although this model is still widely used, GE itself has not used it since John F. Welch, Jr., became chairman in 1981. As stated in its *Annual Reports*, GE's primary strategic objective since 1981 is to be first or second worldwide in the markets it enters. Otherwise, it will leave the business.

[2]The restaurant industry as a whole is characterized by many competitors and a high failure rate. There are over 250,000 restaurants in the United States alone, and according to the Culinary Institute, located in Hyde Park, New York, about 90% of new restaurants fail in their first year of operation. However, in this example the analysis is done for a local market. The local market for certain types of restaurant may be much more attractive than the industry as a whole.

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