JOURNAL OF SMALL BUSINESS
STRATEGY

DAVID VERSUS GOLIATH: STRATEGIC BEHAVIOR OF SMALL FIRMS IN CONSOLIDATED INDUSTRIES

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ABSTRACT

This study assesses the effect of strategy selection and firm adaptability on small firm performance, using firm tenure as a moderator variable. The study is based upon interviews with sixteen small firms operating in rapidly changing and consolidating industries. All of the firms in the study pursued a differentiation strategy. Half of the firms pursued a broad product strategy and more than three-quarters pursued a broad service strategy. The study found that small firms adapt by addressing community needs and forming cooperative agreements with other small firms but not larger firms. Variation among the industries studied suggests that the intensity of industry concentration affects firm adaptation decisions. For instance, while the heavily concentrated hardware and drugstore industries showed limited adaptation, the unconsolidated bookstore industry showed greater commitment to adaptive strategies. In addition, firm tenure was found to affect the adaptation of the small firms studied.

INTRODUCTION

Small firms face severe competitive challenges. Hirschman (1958) argued that small firms will fail or will be consumed by large firms. Welsh & White (1981) pointed out that because small firms are resource impoverished, they face significant disadvantages when competing head-to-head against larger firms. More recently, McCune (1994) found that the "price chopping" practices of mass merchandising retailers (e.g. Wal-Mart) and category killers (e.g. Home Depot) threaten the survival of small competitors, limit the shopping alternatives for customers, limit the customers to which manufacturers can sell, and decrease the negotiation power of vendors. Fenn (1997) noted that while independence is valued, scale is rewarded. Thus, small firms are challenged when faced with the competition of large firms.

Despite the many competitive challenges faced by small firms, especially those operating in concentrated industries, some have suggested that small businesses do have advantages. These advantages include extraordinary accessibility; customer and market knowledge; close social relations with customers; product, service and geographic specialization; flexibility; and management (Kean, Niemeyer, & Miller, 1996; Litz & Stewart, 2000; Litz, 2000; Longenecker & Moore, 1987). Indeed, there are approximately 23 million small businesses in the United States, which account for nearly half of all goods and services produced and sold and employ more than 99% of all employers (Daft, 2000; Hodgetts & Kuratko, 1995; Kuratko & Hodgetts, 1998; Small Business Administration, 2002). While definitions vary in the studies cited, most are consistent with the SBA definition of less than 500 employees (Federal Register, 2000).

The research reported in this paper was conducted to understand the survival of small firms competing against large firms and to resolve inconsistencies in the literature on small firm viability. The firms in this study were very small, usually less than 100 employees. Researchers disagree on (1) whether or not small firms can be successful (e.g., Hirschman, 1958) and (2) if they can succeed, which strategies enable success (e.g., McCune 1994; Porter, 1980b). In addition, the literature suggests that there are certain adaptation approaches, such as cooperation and flexibility that may affect the performance of the firm's chosen strategy (e.g., Fenn 1997; McCune, 1994).

On the assumption that small firm success is particularly problematic in consolidating industries, this study explores in some detail the performance of small firms in three narrowly defined retail industries. The three industries are the highly concentrated drug store industry, the highly concentrated hardware industry, and the rapidly consolidating book selling industry. The study is based on sixteen case studies designed both to analyze the impact of strategy selection, firm adaptability and firm tenure on firm viability as well as to understand in greater detail the nuances of successful small firms' strategies. This study proposes that the strategy of the small firm is related to its performance. The performance of the small firm is also related to its ability to adapt in an ever-changing competitive environment. Furthermore, firm tenure affects the strategy selected by the firm and the adaptability of the firm. The relationships are illustrated in Figure 1 and reviewed in the following sections.

Using a familiar metaphor, the paper seeks to understand "How does David manage to smite or at least live in the same town as Goliath?"

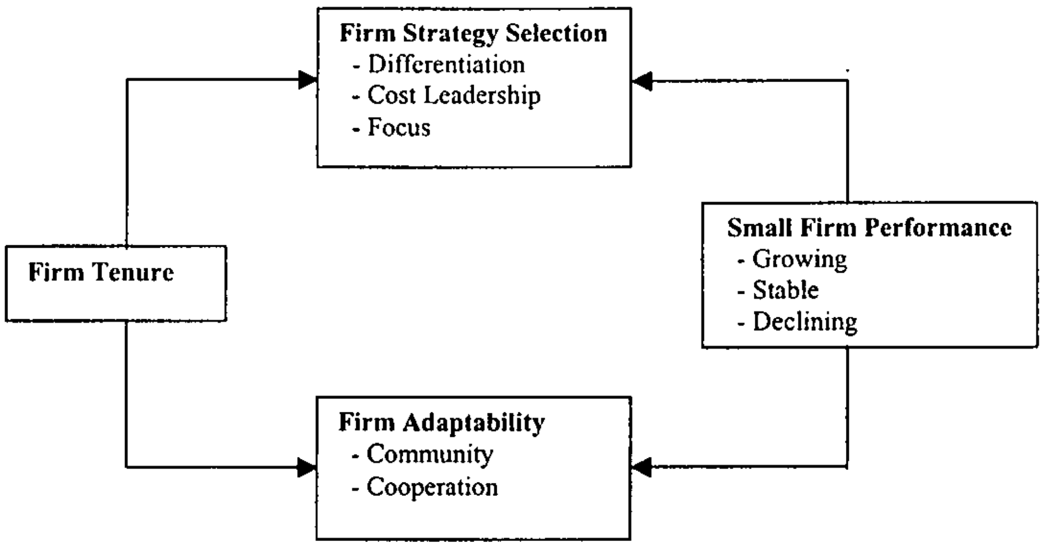
CONCEPTUAL BACKGROUND AND THEORY

In the study of small firms, the performance of the firm has been linked to its competitive strategy, adaptation, and tenure. The following sections review these aspects.

Competitive Strategy

Porter (1980a, 1985) argued that a firm's competitive strategy is linked to its performance. He argued that a firm can gain competitive advantage by pursuing one of three generic competitive strategies: differentiation, cost leadership, and focus. Firms employing a differentiation strategy attempt to distinguish their products and/or services from those of their competitors; they attempt to establish and maintain customer loyalty through uniqueness. Firms using a cost-leadership strategy compete for customers by offering competitive quality at the lowest prices. Firms choosing a focus strategy decide to compete not only on the basis of uniqueness (differentiation) or price (cost leadership) but also by targeting a segment of an industry or market.

FIGURE 1: SMALL BUSINESS STRATEGIC MODEL



Chaganti, Chaganti, and Mahajan suggested that "firms should match strategy to the type of competition in the market, and that effective strategies vary with the type of competition" (1989: 31). They found that firm size limits the competitive strategy options of businesses, with large profitable businesses having more options than small profitable businesses. Specifically, McCune (1994) argued that a cost leadership strategy is infeasible for small firms because they cannot enjoy economies of scale. Instead, he suggested that small firms should differentiate themselves from their competitors by providing something that chain competitors do not provide, such as excellent service or unusual products, as well as practicing good planning and business savvy. Other researchers have found that differentiation through product uniqueness, customer responsiveness, quality, excellent service and convenience has enabled small firms to survive or prosper (Chaganti, et al., 1989; Lieber, 1997; Macht, 1999). In addition, Chaganti, et al. (1989) found that differentiation in terms of quality aided performance, while differentiation through innovation did not affect performance. In light of the above literature, it would appear that a small firm's performance is related to implementing a differentiation strategy. Accordingly,

> ***H1: A small firm is more likely to succeed by implementing a differentiation strategy than by implementing a cost leadership strategy.***

In addition to pursuing a differentiation strategy, small firms may also gain competitive advantage by carving a niche in the marketplace or pursuing a focus strategy. For example, McCune (1994) found that local stores that carved out a niche not filled by Wal-Mart improved their performance because Wal-Mart shoppers eventually spilled over into the local stores. Thus, he argued that small businesses should (1) focus upon their niche, (2) narrow and deepen their product line, (3) offer superlative service, and (4) remain knowledgeable about consumers, competition, and pricing. In addition, Kean, et al. (1996) found that concentration on a unique market segment allows small retailers to differentiate the product assortment and to incorporate cost or pricing strategies that best serve their defined market. Longenecker and Moore (1987) proposed that by clearly understanding their customers and markets through maintaining close contact with their customers, small firms are well suited to specialize and develop expertise in a product, service and/or specific geographic market. Accordingly, because there are distinctions in the arguments between the product array and the range of services, it is hypothesized that:

H2a: A small firm is more likely to succeed using a focus product strategy than a broad or narrow product strategy.

H2b: A small firm is more likely to succeed using a focus service strategy than a broad or narrow service strategy.

Firm Adaptability: Community and Cooperation

In addition to Porter's three competitive strategies, there are other strategic factors that affect the performance of small firms. Fenn (1997) pointed out that while small firms have built-in disadvantages regarding economies of scale in purchasing, production, and information systems, these competitive disadvantages can be partially offset through entrepreneurial tactics such as adaptation. Indeed, small businesses can be more adaptable because they have lower overhead costs than large firms (Longenecker & Moore, 1987).

Adaptation may involve addressing changes or developing social relations in the community in which small businesses operate (Chell & Haworth, 1992; Litz & Stewart, 2000; Maggina, 1992; Maurer, 1998). More specifically, Daft (2000) suggested that entrepreneurial growth opportunities exist for small firms that take advantage of or adapt to changing community demographic and lifestyle trends. Thus, because fulfilling a community need may be linked to the small firm's performance, it is hypothesized that:

H3: A small firm is more likely to succeed by adapting its product and/or service to fulfill a unique community need.

Cooperation is another form of adaptation. For small firms competing against industry giants, cooperation is a survival mechanism (Fenn, 1997; Maggina, 1992; McCune, 1994). Small businesses cooperate by aligning with other small firms to benchmark, develop quality standards, form buying cooperatives, refer customers, and develop joint marketing. Ehrenfield (1995) found that when small businesses in the office supply industry formed strategic collective purchasing alliances, they were able to lower prices. In addition, small business owners that adapt by cooperating with large businesses may enable their survival (Lieber, 1997; McCune, 1994). According to Fenn (1997) and Litz (2000), however, such collaboration can be risky because it may result in loss of competitive advantage, dilution of market share, exposure of weaknesses, damage to customer relationships and reduced margins. In light of the above literature, this study hypothesizes that:

H4a: A small firm is more likely to succeed by seeking cooperative agreements with other small firms.

H4b: A small firm is more likely to succeed by seeking cooperative agreements with large firms.

Firm Tenure

Although Davis & Thompson (1994) found that there is no relationship between firm tenure and strategic positioning, including the decisions to differentiate or pursue a narrow focus, other scholars argue that tenure is important. Thus, in the study of small firm performance, tenure is of interest. Porter (1996) asserted that new entrants, unencumbered by industry history, often discover unique positions overlooked by established competitors. New strategic positions often open up due to changes such as new customer groups, new needs, new distribution channels, or new technologies. New firms, less wedded than old firms to past practices, are able to identify these novel strategic positions more easily than older firms. In terms of choosing a differentiation or focus strategy, Kean, Leistitz, Gaskill and Jasper (1998) found that older small firms may be better able to survive without differentiating or narrowing their focus due to their established reputations and ties to their industries. It appears that as firms age, they are less likely to engage in adaptive strategies such as meeting a unique need in the community or forming cooperative agreements. Accordingly, this study hypothesizes that tenure will have a profound impact on a firm's strategic options.

H5a: As firm tenure increases, a small firm is less likely to select a differentiation strategy.

H5b: As firm tenure increases, a small firm is less likely to select a focus strategy.

H5c: As firm tenure increases, a small firm is less likely to adapt by meeting a community need.

H5d: As firm tenure increases, a small firm is less likely to adapt by forming cooperative agreements with other firms.

METHODOLOGY

This study uses a linear-analytic, multiple-case design (Yin, 1994) to explore the performance of small firms competing against industry giants. "Case studies are the preferred strategy when "how" and "why" questions are being posed, when the investigator has little control over events, and when the focus is on a contemporary phenomenon within some real-life context (Yin, 1994: 1). The firms were selected for the case studies from three highly consolidated retail industries – the bookstore, hardware, and drugstore industries. The firms studied were located in major metropolitan areas throughout the United States, the majority in the East Coast. According to Davis and Thompson (1994), industry context plays a critical role in a firm's ability to succeed. To facilitate a deeper understanding of how small firms are succeeding in these consolidated industries, an industry analysis was first conducted followed by in-depth interviews with small business owners. In case studies, the advantage of interviews is that they are focused directly on the topic studied.

Industry Analysis

Of the three industries included in this study, the bookstore industry is the least consolidated. As of the end of 2000, the $18 billion bookstore industry was actively consolidating, with the top five competitors commanding a combined market share of 52%. The established firms -- Barnes & Noble ($3.62 billion), Borders ($3.27 billion), and Books-A-Million ($0.42 billion) -- had the majority of the market share. The "Internet upstarts" Amazon.com ($1.69 billion) and Barnesandnoble.com ($0.32 billion) captured a significant share of the market (United

States Securities and Exchange Commission, 2001; Milliot, 2002). By contrast, the hardware and drug store industries are almost fully consolidated. In the hardware industry, The Home Depot ($38.4 billion) and Lowes Companies, Inc. ($15.9 billion) controlled 94% of the $57.65 billion hardware market share (Stockselector.com, 2000). Similarly, the $60.05 billion drug store industry is so consolidated that the top four competitors controlled virtually 100% of the total market share. The top competitors in the drug store industry were Walgreens ($19.6 billion), CVS ($18.4 billion), Rite Aid ($13.4 billion), and Eckerd ($12.6 billion) (Walgreen's Rankings & Ratings, 2000).

Data Collection

Given the extreme competitive pressures facing firms in the highly consolidated industries described above, the challenges confronting small firms in any environment, and the lack of detailed theory on small firm competitive strategy, there is a need for both exploratory research and hypothesis testing. To meet this need, primary data was collected through personal interviews. The in-depth interviews allowed sufficient time to explore the development, maintenance, and alternative strategies that small businesses were using to compete against large competitors.

Elite interviewing was selected as the primary qualitative method of unit analysis. Elite interviewing is a specialized and qualitative interviewing technique that focuses the research on persons within the organization who have selected expertise in the areas most relevant to the research (Marshall & Rossman, 1995). The elite interviewees selected to participate were small business owners and who were considered "elite" because of their expertise in the issues under investigation in this study. Each interviewee was responsible for strategy selection, was the most knowledgeable about local competition, and could provide descriptive information about the firm's past history, performance, and future plans. The interviews provided in-depth information about the areas most relevant to the study.

A semi-structured interview style was selected to allow the interviewees the opportunity both to reflect on their experiences and to use their knowledge and expertise to uncover and describe various strategy selection and adaptability decisions. Open-ended interview questions were developed based on the results of an extensive literature review and industry analyses. These questions are presented in Appendix 1. The interviews lasted thirty minutes to two hours and were conducted between the fall of 1998 and the spring of 2000 either by telephone or in person. Four bookstore owners, five hardware store owners, and six drug store owners were interviewed.

To ensure confidentiality, responses were collected through the note-taking method rather than the tape-recorded method (Marshall & Rossman, 1995). To further protect the confidentiality of the firms, each firm was assigned an alternate name consisting of a letter for each industry and a number for each store. Thus, B1, B2, B3, and B4 represented firms in the bookstore industry. Hardware stores were represented by H1, ... H6. Drug stores were represented by D1, ... D6.

Following Dess and Robinson (1984), who found that self-report assessments are accurate representations of general performance data, the study relied solely upon the qualitative information obtained in the interviews as a proxy of firm performance. The interviewees' responses were paraphrased to form a structural framework for the study's data analysis. As patterns and themes became apparent in the data, two reviewers independently grouped the responses into identified categories. Inferences from the data along each of the hypotheses were identified. Where the firm results were virtually uniform, the assessment had greater certainty. If the results were less evident (e.g. seven out of sixteen firms have cooperative agreements), then the outcomes were identified as having "partial support." Because the number of firms analyzed was limited and because the study was exploratory, the conclusions drawn from each of the hypotheses needs to be regarded as likelihood rather than as a certainty.

RESULTS

The in-depth personal interviews provided rich information about small firm strategy while also allowing preliminary evaluation of this study's specific hypotheses concerning the affect of small firm strategy selection, firm adaptation, and firm tenure on firm performance. Results are presented in Table 1a and 1b.

TABLE 1a: INTERVIEW DATA – Hypotheses H1 to H4b and Firm Performance

Industry/ Firm	***H1: Strategy:***	***H2a: Product:***	***H2b: Service:***	***H3: Adapt:***	***H4a: Adapt:***	***H4b: Adapt:***	***Firm Performance:***
	DF vs. CL	Focus vs. Broad or Narrow	Focus vs. Broad or Narrow	Meeting Community Need	Cooperation with small firms	Cooperation with large firms	Growing, Stable, and Declining
Bookstores							
B1	DF	F	B	Yes	Yes – FA	No	G
B2	DF	N	B	Yes	Yes – FA	No	G
B3	DF	F	B	Yes	Yes – FA	No	G
B4	DF	B	B	No	Yes – FA	No	G
Hardware Stores							
H1	DF	B	F	No	Yes – TA	No	G
H2	DF	B	B	No	No	No	G
H3	DF	B	B	No	No	No	S
H4	DF	B	B	No	No	No	G
H5	DF	B	B	No	No	No	G
H6	DF	B	B	No	No	No	G
Drug Stores							
D1	DF	F	F	Yes	No	No	G
D2	DF	B	B	No	No	No	S
D3	DF	F	B	No	No	No	G
D4	DF	N	B	No	No	No	D
D5	DF	F	B	No	Yes – TA	No	G
D6	DF	N	F	No	Yes – TA	No	D

KEY: *B- Broad, CL – Cost Leadership, D – Declining, DF – Differentiation, F- Focus, FA – Formal Agreement, G – Growing, MO – Middle-Old, N – Narrow, NF – No Focus, O – Old, S- Stable, TA – Tacit Agreement, Y – Young, YM – Young-Middle*

TABLE 1b: INTERVIEW DATA – Hypotheses H5 to H5d and Firm Performance

Industry/ Firm	*H5: Firm Tenure:* Young, Young-Middle, Midde-Old, and Old	*H5a: Strategy:* DF vs. CL	*H5b: Focus:* Strategy	*H5c: Adapt:* Meeting Community Need	*H5d: Adapt:* Cooperation with small or large firms	*Firm Performance:* Growing, Stable, and Declining
Bookstores						
B1	23 – YM	DF	F	Yes	Yes	G
B2	20 – YM	DF	NF	Yes	Yes	G
B3	22 – YM	DF	F	Yes	Yes	G
B4	28 – YM	DF	NF	No	Yes	G
Hardware Stores						
H1	1 – Y	DF	F	No	Yes	G
H2	43 –MO	DF	NF	No	No	G
H3	43 – MO	DF	NF	No	No	S
H4	97 – O	DF	NF	No	No	G
H5	91 – O	DF	NF	No	No	G
H6	7 – Y	DF	NF	No	No	G
Drug Stores						
D1	5 – Y	DF	F	Yes	No	G
D2	40 – MO	DF	NF	No	No	S
D3	30 – YM	DF	F	No	No	G
D4	76 – O	DF	NF	No	No	D
D5	25 – YM	DF	F	No	Yes	G
D6	25 – YM	DF	F	No	Yes	D

KEY: *B- Broad, CL – Cost Leadership, D – Declining, DF – Differentiation, F- Focus, FA – Formal Agreement, G – Growing, MO – Middle-Old, N – Narrow, NF – No Focus, O – Old, S- Stable, TA – Tacit Agreement, Y – Young, YM – Young-Middle*

The study identified three levels of firm performance: declining, stable, and growing. "Declining" firms exhibited decreasing sales and/or earnings; "stable" firms had relatively constant revenues and/or earnings; and "growing" firms had increasing sales and/or earnings. Based on the study's characterizations of successful performance, there were twelve "growth" firms, two "stable" firms, and two "declining" firms. Thus, this study's sample is composed largely of firms that are succeeding against the odds. Nevertheless, although there was limited variation found in this study, the results shown in Table 2 suggest that there would be considerable value to conducting this research on a much larger scale

TABLE 2: RESULTS

Hypothesis 1	***Growth***	***Stable***	***Decline***
Differentiation Strategy	12	2	2
Cost Leadership Strategy	0	0	0
Hypothesis 2a	***Growth***	***Stable***	***Decline***
Broad Product Strategy	6	2	0
Narrow Product Strategy	1	0	2
Focus Product Strategy	5	0	0
Hypothesis 2b	***Growth***	***Stable***	***Decline***
Broad Service Strategy	10	2	1
Narrow Service Strategy	0	0	0
Focus Service Strategy	2	0	1
Hypothesis 3	***Growth***	***Stable***	***Decline***
Community Need	4	0	0
No Community Need	8	2	2
Hypothesis 4a	***Growth***	***Stable***	***Decline***
Cooperative with Small	6	0	1
No Cooperation	6	2	1
Hypothesis 4b	***Growth***	***Stable***	***Decline***
Cooperative with Large	0	0	0
No Cooperation	12	2	2
Hypothesis 5a	***Differentiation***	***Cost Leadership***	
Young	3	0	
Young-Middle	7	0	
Middle-Old	3	0	
Old	3	0	
Hypothesis 5b	***Broad Product/Service***	***Narrow Product/Service***	***Focus Product/Service***
Young	2 / 1	0 / 0	1 / 2
Young-Middle	1 / 6	2 / 0	4 / 1
Middle-Old	3 / 3	0 / 0	0 / 0
Old	2 / 3	1 / 0	0 / 0
Hypothesis 5c	***Community Need***	***No Community Need***	
Young	1	2	
Young-Middle	3	3	
Middle-Old	0	3	
Old	0	3	
Hypothesis 5d	***Cooperation Small/Large***	***No Cooperation Small/Large***	
Young	1 / 0	2 / 3	
Young-Middle	6 / 0	1 / 7	
Middle-Old	0 / 0	3 / 3	
Old	0 / 0	3 / 3	

Hypothesis 1. In exploring the strategy of small firms, all interviewees reported that their firms were implementing a differentiation strategy rather than a cost leadership strategy. In addition, the majority of the firms (i.e., 13 out of 16 firms) reported growing sales and profits. This first hypothesis stipulates that "a small firm is more likely to succeed using a differentiation strategy than a cost leadership strategy." While the uniformity of the surviving firms were using a differentiation strategy, no direct conclusion about the accuracy of this hypothesis can be made given the absence of firms pursuing a cost leadership strategy.

Hypotheses 2a and 2b. In terms of *product* strategy, only four interviewees reported using a *focus product* strategy. Of these firms, two were bookstores and two were pharmacies; none of the hardware stores implemented a *focus product* strategy. Based on a count of the responses, hypothesis 2a – "a small firm is more likely to succeed using a *focus product* strategy than a *broad* or *narrow product* strategy" was not supported. In terms of *service* strategy, only three used a *focus service* strategy, one of which also used a *focus product* strategy. Based on the count of the responses, hypothesis 2b – "a small firm is more likely to succeed using a focus service strategy than a broad or narrow service strategy" was not supported. In total, only seven of the sixteen firms used either a *focus product or focus service* strategy. In addition, eight of the firms used a *broad product* strategy, thirteen of the firms used a *broad service* strategy, and thirteen firms used some form of *broad* strategy.

Hypothesis 3. Only four of the interviewees reported that their firms adapted to meet a special need in the community. Based on a count, the majority of the responses indicate that hypothesis 3 – "a small firm is more likely to succeed by adapting its product and/or service to fulfill a unique community need" was not supported. Three of the four firms, which reported that they adapted to meet a community need, were bookstores, all of which were growing firms in a consolidating (but not yet concentrated) industry.

Hypotheses 4a and 4b. In examining whether small firms succeed using cooperative agreements with other small firms, seven of the firms were found to adapt by cooperating with other small firms. Thus, based on a count of the responses, only partial support was found for hypothesis 4a "a small firm is more likely to succeed by seeking cooperative agreements with other small firms." All of the bookstores had cooperative agreements with small firms, so hypothesis 4a was supported in the bookstore industry. None of the small firms had cooperative agreements with large firms. The majority of the responses indicate no support was found for hypothesis 4b – "a small firm is more likely to succeed by seeking cooperative agreements with large firms."

Hypotheses 5a, 5b, 5c, and 5d. Firm tenures ranged from one year to 97 years, with an average tenure of 36 years. Firms were classified as "young," "young-middle, "middle-old," and "old." There were three "young" firms, with tenures of 1 to 10 years; seven "young-middle" firms, with tenures of 11 to 30 years; three "middle-old" firms, with tenures of 31 to 50 years; and three "old" firms, with tenures of 51 years or more. The bookstore industry, with an average tenure of 23.25 years, is best characterized as "young-middle." The hardware stores and the drug stores both are characterized as "middle-old" with average tenures of 47 and 33.5 years, respectively. The twelve firms that were growing were distributed across all age categories, with only the "middle-old" firms showing a tendency towards stability rather than growth. Of the two "declining" firms, one was "old" and one was "young-middle."

Since all firms selected a differentiation strategy, hypothesis 5a, which stated "as firm tenure increases, a small firm is less likely to select a differentiation strategy" cannot be assessed. There was, however, support for hypothesis 5b - "as firm tenure increases, a small firm is less likely to select a focus strategy." All the firms that pursued a focus strategy fell into the young or young-middle categories, and the majority of the firms in the young or young-middle categories pursued such a focus strategy. Thus, a count of the responses indicates that increased firm tenure is related to a broader focused line of products or services; the majority of the middle-old and old firms pursued a broad strategy.

In assessing the relationship between firm tenure and adaptability, all of the firms that adapted to specific community needs were young or young-middle. No middle-old or old firms adapted by meeting a community need. This supports hypothesis 5c – "as firm tenure increases, a small firm is less likely to adapt by meeting a community need."

Turning finally to the relationship between firm tenure and adaptation through cooperative agreements with other firms, seven of the ten younger firms had some sort of cooperative agreement with other firms. None of the middle-old or old firms formed a cooperative agreement with other firms, thus supporting hypothesis 5d – "as firm tenure increases, a small firm is less likely to adapt by forming cooperative agreements with other firms." Interestingly, all cooperative relationships that were formed were with other small firms. No cooperative agreements were formed with large firms.

DISCUSSION

The results of this study provide some interesting insight into the performance of small firms competing against large firms. There was clearly an effect of strategy selection and firm adaptability on small firm performance.

Competitive Strategy

The rich detail gleaned from the elite interviewees provided important insight into the decision-making strategies used by small firms. With regard to the strategy selected by small firms, the results of this study indicate that small firms use differentiation strategies rather than cost leadership strategies. This is consistent with the literature that argues that it is more beneficial for a small firm to use a differentiation strategy (Chaganti, et al., 1989; Lieber, 1997; Macht, 1999; McCune, 1994). Given that most of these firms were successful, the results suggest that a small firm is more likely to succeed by selecting a differentiation strategy than a cost leadership strategy.

In terms of offering differentiated services, firm owners unanimously cited "customer service" or "personal service" as keys to their longevity. Most firms offered the relatively common services of special ordering and/or special sourcing, backed by deep knowledge of their customers and wares. Two of the drug stores differentiated themselves by offering home delivery services. Firm owners also differentiated themselves through their product lines. For instance, drug stores differentiated themselves by providing a variety of merchandise ranging from surgical supplies, to a full line of horse and other pet products, to a variety of gift items and gourmet candy. One hardware store differentiated itself by offering an extensive array of Christmas merchandise; the owner's display of Christmas merchandise is so extensive that it prompts customer inquiries as early as September. In addition, one bookstore developed such a deep collection in certain subject areas that scholars from around the world visit regularly.

While all of the firms used a differentiation strategy instead of a cost leadership strategy, most also implemented a cost-minimization strategy. All but one of the pharmacies, bookstores, and general hardware stores tried to control costs by using management information systems of various levels of complexity. Nevertheless, none of them was able to use technology as extensively as their larger competitors. For example, only one of the bookstores studied was working toward establishing a presence on the Internet, despite the huge rise of book sales over the net. Small firms may be severely disadvantaged if they do not respond to technology changes quickly.

While successful small firms used both differentiated and cost-minimization strategies, the study found that successful small firms used neither a focus product strategy nor a focus service strategy. Rather, they used either a broad or narrow service or a broad or narrow product strategy. The majority of the firms pursued a broad strategy – product or service. This evidence supports the arguments of Chaganti, et al. (1989) who found that firms with broad product ranges outperformed those with narrow product ranges. However, two of the bookstores did focus. They focused upon very specific audiences (e.g., readers of critical theory) in part by developing extremely deep and focused product lines. In addition, one of the drug stores offered a truly focused and personalized delivery service; it delivers staple items (e.g., toothpaste) along with prescriptions to the elderly at no additional cost.

Adaptability

In general, adaptation to a community need was not found to be related to small firm performance. However, adaptation to a community need was found to be related to the performance of small bookstores. The majority of the bookstores responded to competitive pressures through some form of adaptation. Of the bookstores that did respond to such competitive pressure, they were also labeled as "growing." This finding suggests that in growing firms, adaptation may be linked to performance. In addition, the bookstore industry is consolidating but less concentrated than the hardware and drug store industries. This diminished industry concentration may suggest that in such an industry, constant adaptation may be advantageous (even necessary).

Adaptation by forming cooperative agreements with other small firms was found to be common among the small firms studied. However, agreements with large firms were not found to be part of small firm performance. In particular, all of the bookstores in this study had formal cooperative agreements with other small firms. Given that all of the bookstores in the sample were growing, adapting by forming cooperative agreements may be linked to the growth of small firms. In addition, the on-going consolidation of the bookstore industry may have encouraged bookstores to develop cooperative agreements with other small firms.

The interviews suggested that cooperative arrangements might play a particularly important role in cost minimization strategies. The hardware stores, for example, gained access to sophisticated management technologies needed for aggressive buying through their supply cooperatives (e.g. TruServ), while the association of independent booksellers, the American Booksellers Association, provides the same service to bookstores. In addition, drug store owners were able to reduce their fixed overheads by trading high-priced prescription drugs with other independent stores at cost.

The combined results for hypotheses 3, 4a and 4b indicate that, while small businesses may have the ability to adapt (Longenecker & Moore, 1987), small firms do not have to adapt to be successful. The results from this study do not support the literature that suggests that small firms should adapt to be successful (Chell & Haworth, 1992; Daft, 2000; Ehrenfield, 1995; Fenn, 1997; Lieber, 1997; Maggina, 1992; Maurer, 1998; McCune, 1994).

Tenure

The findings regarding tenure effects are mixed. As to the competitive strategy, all the firms selected a differentiation strategy. Tenure appears to affect whether a firm chooses a more focused line of products or services aimed at a niche market: All the firms that elected to narrow their foci fell into the young or young-middle categories, and 70% of the firms in those categories chose to focus. In sum, "younger" firms (i.e. less than 30 years old) seem more likely to select a focus strategy, form cooperative agreements with other small firms, and/or adapt to community needs. This finding may, however, reflect industry effects since such a large proportion of the "younger" category is bookstores, which are in a consolidating rather than a concentrated industry. The results suggest that there is no association between firm tenure and firm performance.

Strategic Distance

The interviews also suggested that many successful small firms thrive to the extent that they can create and maintain cultural and/or product/service distance, in addition to or instead of geographical distance, from industry behemoths. Geographic distance is clearly an important factor to consider, especially for hardware stores. Hardware store owners noted that the further their stores were located away from larger powerful competitors like Home Depot the less their stores were threatened. Equally important, at least for bookstores, may be "perceptual distance." For example, as suggested by McCune (1994), one bookstore continues to thrive a mere block from a superstore (e.g., Borders) by eschewing bestsellers and offering intellectual and cultural fare that appeal to sophisticated book buyers.

As helpful as the varying forms of distance may be, this distance may well be eroded as larger firms turn their attention to smaller niches and/or shift the rules of competition by, for example, increasing their use of the Internet. According to Kleindl (2000), the Internet allows larger firms to compete directly with smaller firms in their niche markets at virtually no additional cost. Further, as the large competitors with strong brand names such as Amazon.com, Home Depot, and RiteAid, establish a first mover advantage on the Internet, and thus capture market share and achieve scale economies, they will become more and more formidable.

The interview detail suggests that small firms may indeed be able to mitigate such competitive pressures by honing their ability to employ adaptive strategies rather than engaging in head-to-head competition – at least while there is still time and space to do so. While adaptive strategies seemed only weakly related to firm performance in this study's results, in the still consolidating bookstore industry, three of the four bookstores adapted to meet a specific community need. All of these stores adapted by cooperating with other independents to, among other things, challenge the dominant competitors. (See also Milliot 1999).

Adapting to meet the needs of a unique community and other forms of close association with a well-defined customer group and/or community may also increase the stock of social relations or "social capital" that entrepreneurs can actually translate into concrete economic advantage (e.g. Granovetter, 1985). For example, one of the bookstores was able to buy its building for less than market value despite offers from a large competitor; another received advanced information from concerned community members about changes in the leases of nearby superstores; and a third was able to raise from its customers the down-payment needed to buy the store.

Environmental Constraints

The interviews also highlighted the impact of the wider environment on small firm strategies and performance. Despite the dominance of industry leaders, small drug stores reported that insurance companies, not drugstore chains, were their most threatening adversaries. The growth in third-party prescription plans and repeated changes in insurance company prescription policies cause more pain than direct competition because they cut into the independents' traditional profits from prescription sales. Several drug stores complained that brand-name drug sales now act as loss leaders. One drug store owner even pointed out that although the firm is now doing twice the business than it had done twenty-five years ago, the firm would make more profit today selling Christmas decorations than prescriptions. The erosion of earnings has become so severe that two of the six pharmacy owners are planning to tread water until they can retire.

The drug store owners' dilemma highlights another external factor that may affect small firm strategy and performance – proprietor age. Treading water until retirement may make good sense for an older owner but would not be a feasible strategy for a younger owner. As a result, one "younger" drug store owner responded to third-party drug prescription plan pressures by shifting focus and receiving the training necessary to sell medical and surgical supplies.

IMPLICATIONS

Historically, small businesses have been at a disadvantage in competing against larger firms and chains. Clearly they lack the economies of scale of their larger competitors. Their competitive advantage lay, instead, with greater knowledge and intimacy of their targeted consumers and their needs. The principal evidence in this study showed that this depth of consumer knowledge appeared to assist the unconsolidated bookstore industry the most by allowing the majority of the firms within this industry to adapt more appropriately and more quickly despite their smaller size. Managers will need to review industry structural and technological characteristics to ensure that their firm is sufficiently adaptive.

Responsiveness to a firm's environment or adapting to communities in the form of cooperation with other small firms requirements remains a key countermeasure for small firms. Firm owners who are not currently doing this on a regular basis need to reassess their strategy. Clearly combining efforts such as purchasing with other small firms will help generate improved economies of scale.

Although cooperation with larger firms remains a possibility, it was not evident in this study. A retail hardware store that specializes in restoration hardware, for example, could develop a reciprocal tacit agreement to send customers that need items which are impractical to carry (e.g., rider movers) to the larger chain. The small firm could then be the recipient of customers for the specialty products that are uneconomical for chain stores. The sales loss, if any, to the large firm would be minimal.

The discussion of physical, cultural, and product distance from large competitors has some explanatory value for practitioners. The closer the small firm's understanding of the needs of the consumer and how the small and large firm both provide for their needs, the greater the ability to embed these differences or attributes in the customer's mind.

Despite the small firm's ability to create strategic distance from their competitors, there was a significant gap in the technology employed in the small firms studied. While there was some evidence of firms using computerized information systems, there was virtually no evidence of firms using Internet technology. Firms that overlook this facet of business will face increasing productivity problems and lost sales. The transformation of the bookstore industry is a reminder of the speed and impact of this type of change.

Lastly, regardless of smaller firm counter measures, some industries will remain more hospitable to small firm survival then others. The consolidation of the drugstore industry is an example of a changing and increasingly hostile industry. This study identified multiple owners in this industry who were waiting to retire. Absent any change, the economics increasingly will force more independent pharmacies out of business. In this case, a rational move is to withdraw from the market. Proactive responsiveness to these trends may mean a career change for the owner.

CONCLUSIONS

Despite the competitive pressures in each of the industries studied – bookstores, drug stores and hardware stores, there are examples of small firms that not only survive but thrive. For both practical and theoretical reasons, it is useful to discern the approaches to strategy that have enabled these "Davids" to slay, outrun, or avoid the "Goliaths."

The premise of the study was that successful small firms use differentiation strategies, have a product and/or service focus, and adapt in special ways. It was hypothesized that an entrepreneur's intimate knowledge of a well-defined customer group would provide both strategic ideas for developing focus and for developing subtle early-warning detection of changes in their customers' predilections. However, the intensity of industry consolidation and the proliferation of technology seem to threaten the effectiveness of these strategies.

While all firms studied employed differentiation strategies, only the youngest firms in highly consolidated industries like the hardware industry and the drug store industry adopted focus or adaptive strategies in areas unexplored by existing competitors. In the consolidating bookstore industry, on the other hand, nearly all of the stores studied were trying some form of focus and/or adaptive strategy. Together, these observations suggest that the degree of industry consolidation may have a decisive effect on the types and effectiveness of strategies available to small firms. Further research into the relationship between these factors and the availability and success of various strategies is recommended.

All the interviews highlighted the difficulty of maintaining market share and profits as industry standards and customer expectations grow. The power gained by consolidation and the efficiencies gained through technology seem to raise the threshold of operational effectiveness necessary for survival in a given industry. To keep playing, small firms may need to raise their standards of operational effectiveness *while* either aggressively defending their niche or responding to changes in the industry by discovering new way of competing (e.g. adapting to new community need). Thus, an area of future research would be to define and measure the minimum level of operational effectiveness in various industries; to study if, over time, consolidation does raise the minimum standards; and to determine if the effects are similar across industries.

A limitation of this study is that the majority of the firms studied were growing. Future research should examine successful and unsuccessful firms. The inherent unequal design limitation made quantitative statistical analysis impossible. It was also difficult to identify firms that had failed and to interview owners of failed businesses as to the reasons for their firm's poor performance. Another limitation of this study is the lack of systematic selection of the geographic location of the firms. The firms were selected largely based upon convenience.

Although case studies generally involve smaller number of firms analyzed than do surveys, future research testing the results of this study on a large sample of firms using a survey would benefit the understanding of small firm performance. Case studies rely on analytical generalization rather than statistical generalization as does survey research (Yin, 1994), and so the small number of firms examined in this study is legitimate. Future research should survey a large sample to test the results of this exploratory multi-case study.

In conclusion, for the last few decades the field of strategic management has wrestled with the question of how some small firms thrive despite pressures from the huge competitors that have grown through industry consolidation. This study developed a strategic framework that highlights some of the key factors that account for small firm performance. Data drawn from the interviews support some of the hypotheses while raising additional questions regarding the impact of increasing consolidation especially in the presence of today's ever-changing technological landscape. Successful small firms were found to use a differentiation strategy, cost minimization, broad or narrow product/service strategy, cultural and /or product/service distance, and adaptive strategies rather than head-to-head competition. It is hoped that the knowledge gained as a result of this analysis will enable small firms to take a more proactive stance in terms of making the decisions that may affect not only their performance but also ultimately their survival.

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APPENDIX 1: INTERVIEW QUESTIONS

Q: How long has your firm been in business? Are you or is your family the original owner? (Encourage "history" of the store.)

Q: Who are your main competitors? When did they move to the area? What is their proximity to your store?

Q: What is the most important component of your overall business strategy? How do you compete with the local mass merchandisers or large chains?

Q: Do you believe that customer loyalty makes up a large percentage of your revenue?

Q: What types of products do you stock? Have you changed your product mix? When and why? What makes your merchandise and/or service different from that of your competitors?

Q: Do you carry specialty products? What types? Why?

Q: Do you have cooperative agreements with other small firms? If so, when did you form them and why? Are they written or verbal?

Q: Do you have cooperative agreements with large firms? If so, when did you form them and why?

Q: Has the community or town borough offered their assistance to help your store in anyway? If so, what types of assistance have they offered your store? What years did they offer this assistance?

Q: How many people do you employ? What are your annual sales? How have they changed? What is your profit margin? How has it changed?