

SMALL BUSINESS PRIMER

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THE PRIMERS PURPOSE

This document was compiled in order to provide those seeking to start a business with the foundation required for success. The small business market place is comprised of many fundamental truths and it is my belief that bringing these truths to light will equip the aspiring business owner with the knowledge he or she will need to survive. I suggest you print this document out, grab a highlighter, and comb through the following information carefully

THE SMALL BUSINESS PARADIGM

In short small business is small business because large business has allowed it to exist. Larger organizations determined that the pursuit of smaller markets is not worth the effort. Big business by nature pursues opportunities that require larger capital investments and yield minimal fluctuation. Small businesses by nature pursue opportunities that require a smaller capital investment and have higher market fluctuation. Consequently the opportunities that exist for a small business exist in markets that are inherently risky.

“small businesses possess certain resources that allow them to overcome some barriers which create greater difficulties for their larger counterparts, as well as allow small businesses to exploit certain industry opportunities more readily than larger ones” (Dean, Brown, and Bamford 1998)

A small firm is agile and flexible allowing it to move and change to meet the varying demand of a fast changing market. A larger firm will be more inclined to focus on opportunities that can be exploited by greater finances and the requirement for more resources.

“The resources and capabilities of a firm will attract them to a particular industry environment.” (Dean, Brown, and Bamford 1998)

Potential customers are looking to small businesses for high quality custom solutions. Maintaining real-time feedback and providing fast turnarounds are essential when conducting business on a smaller level. Customers turn to larger companies when they are looking for lower price prepackaged solutions.

YOU ARE THE BUSINESS

It is important to realize that you and your business are one. Regarding the initial stage of a business Neil C. Churchill found that;

“The organization is a simple one – the owner does everything ...systems and formal planning are minimal to non-existent. The company’s strategy is simply to stay alive. The owner is the business, performs all the important tasks, and is the major supplier of energy, direction, and, with relatives and friends, capital.” (Churchill1983,3)

If you are wondering about your likelihood for success with business take a look in the mirror. Your ability to turn a profit with a business is closely tied to your ability to make money as an individual. How you manage your personal finances is a direct reflection of how you will manage the finances of your small business. Before starting a business make sure you have your personal finances in order. Establishing successful habits on a personal level will yield high returns on a professional level.

SMALL BUSINESS AS A SERVICE

The fundamental advantages of a small business allows for a good fit in service sectors. Services fit well into the small business paradigm because they often don’t require a high overhead and the solutions they provide are a function of the specific needs of each individual client. Large businesses are not in a position to meet such demands. Larger organizations are positioned to break into markets that have larger capital and resource oriented barriers of entry.

The labor/capital distribution will appear similar to the graph shown in figure 4 concerning market types of large and small businesses. Highly capital oriented business types would be located to the right of the spectrum, highly labor (service) oriented business types would be oriented toward the left of the spectrum.

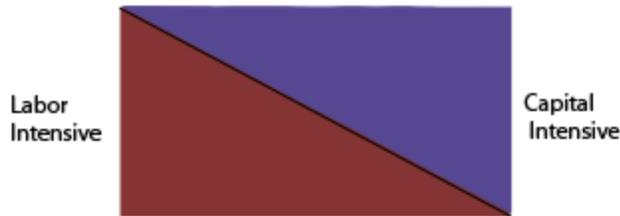


Figure 4. Labor – Capital distribution

High capital businesses would include banks and investment organizations that leverage their capital in order to make a profit. The labor businesses would include organizations that require high man hours in order to produce. Potential entrepreneurs often don't have the capital at their disposal to get into capital intensive businesses but they do have the ability to offer labor intensive services.

SMALL BUSINESS CAPITAL REQUIREMENTS

Capital requirements within any business need to be met in order to continue operation and can be broken down into two categories, financial capital and human capital. Capital in general can be considered the resources available for the use of production. Financial capital concerns the monetary resources and human capital concerns the knowledge or intellectual resources.

FINANCIAL CAPITAL

By definition most small businesses have very little reserves so small businesses are especially concerned about financial capital and the requirement for cash flow. If the demand for a service rises and falls inconsistently and costs remain high a small business can find itself in a compromising situation. Market fluctuations will always be a concern but a bootstrapping small business is especially vulnerable because they don't have the funds to weather too economic storms.

"The main problems presented by seasonality relate to cash flow and overall profitability" (Getz and Carlson 2000,554).

A solution to cash flow concerns is often diversification.

“Risk reduction for the firm is achieved by diversification across products and services produced, across clients supplied, and across input producers.”(Cressy 2006,104).

Although difficult for a small business, diversifying services to accommodate many markets or many needs can allow for a more stable cash flow. Anything that can be done to maintain a constant positive cash flow will be vital in keeping a small business viable. That said, it is better to master one service than to be mediocre at many.

Cash flow requirements and the inability to diversify push for larger margins in smaller business. Larger margins are generally available where competition is low. Competition is low in untapped markets and in markets served by high quality custom solutions. Creating a new path and providing quality solutions is part of being a small business and is required to maintain a competitive advantage over those that lack the flexibility to meet needs that constantly change.

Without cash a business is at risk. Additional cash flow offers more possibilities to diversify. Diversification leads to more stability, and more stability leads to additional cash flow. The growth of a business and ultimately wealth depends on the cycle illustrated in figure 1.

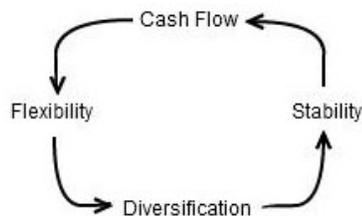


Figure 1. Cash flow cycle

HUMAN CAPITAL

A similar cycle plays into human capital. The longer an individual operates within an industry the more human capital he or she acquires. The greater the human capital the lower the probability of failure. Illustrated in figure 3, human capital dictates the actions, actions create experience, experience leads to understanding, and further

understanding results in greater human capital. This cycle is similar to the growth seen in formal educational environments.

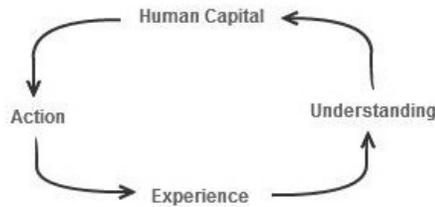


Figure 3. Human capital cycle

ORGANIC GROWTH IS IMPORTANT

Running through the financial and human capital cycles many times is important for long term success. Many entrepreneurs seek for huge results in a short amount of time but an organic [growth strategy](#) will yield a much more stable customer base. While it is vital that a business matures and grow, growth should happen at a reasonable rate. Experiencing each step of the growing process will allow a business to better serve its customers. Too large of a leap too soon can quickly lead to a company's closure. I have watched many local companies fail because they branched out to multiple locations before they were ready. They assumed additional overhead without having the finances in place to carry the stores as demand fluctuated. That said growth is important and should be pursued in a prudent manner.

"Small businesses are merely transitory and will largely disappear in the long run." (Brock and Evans 1988,10)

At the end of the day the largest contributing factors to your success will be your persistence and hard work. Continually building your human capital and investing effort into your business will in time produce a successful company.

REASON FOR CONCERN

Small businesses constitute a large part of our economy and their overall failure rate has been historically high. Identifying and eliminating the elements that contribute to this volatility could have significant economic ramifications. According to the Small Business Administration

Office of Advocacy small businesses in the U.S. pay 44 percent of total U.S. private payroll, and have generated 64 percent of net new jobs over the past 15 years. Small businesses are also the source of more than half of the nonfarm private gross domestic product and are responsible for 97.3 percent of all identified exporters. In the 2007 fiscal year small businesses were cited as producing over 30 percent of the known export value.

In terms of technological advancements small businesses produce 13 times more patents per employee than large firms. These patents are twice as likely as large firm patents to be among the one percent most cited. This is a bit surprising considering 40 percent of the high tech work such as scientists, engineers, and computer programmers exists in the small business sector.

Being such a vital part of our economy one may expect the small business mortality rate to be relatively low, but that is not the case. The ratio of annual business openings to business closures is roughly 1 to 1. In 2008 there were 627,200 new businesses opened, and 639,146 combined closures and bankruptcies. The numbers are consistent across all industry sectors with seven out of ten new firms surviving at least two years, and about half surviving only five years.

Currently every time a small business opens their doors, the doors of another small business close. This is not an ideal circumstance for a thriving economy and should be a concern to you as an aspiring business owner. With the statistics constant across all sectors the largest contributing factor to failure is something other than the market. I believe the issue exists with the individual and their approach to the market place.

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ShyEntrepreneur.com exists to help small, home-based, and young entrepreneurs find success in the world of business. If you have any thoughts or concerns please let us know. All endeavors to help small business are a worthy cause.