**Chapter Two**

**Small Business**

**2.1 Definition and Importance**

**2.1.1 What is Small Business?**

The definition of small-scale industry differs from one country to another. In some countries the term used for such a unit is a small firm, small enterprise, small unit, small business or small-scale industry. Whatever the term used, the definition derived is usually based on a single index, i.e., either on the bases of investment in plant and machinery or labor and power or labor used without any power. As time passed and advancement took place in every spare of activity, the index used underwent tremendous changes. Nowadays, almost all countries consider investment in plant and machinery, i.e., fixed capital as the yardstick to define a small industry.

A small business is a business that is privately owned and operated, with a small number of employees and relatively small number of sales. Small businesses are normally privately owned corporations, partnerships, or sole proprietorships. The definition of the term “small business” can vary from country.

Specifying any size standard to define small business is necessarily arbitrary, because people adopt different standards for deferent purpose. For example, legislators may exclude small firms from certain regulations and specify them employees as the cut off point. Moreover, a business may be described as “small” when compared to large firms, but “large” when compared to smaller ones. For example, most people would classify independently owned gasoline stations, neighbourhood restaurants, and locally owned retail stores as small business. Similarly, most would agree that the major automobile manufacturers are big business. And firms of in between sizes would be classified as large or small on the bases of the individual viewpoints. There are two approaches to define small business.

**Size Criteria**-Even the criteria used to measure the size of business vary. Size refers to the scale of operations. Some criteria are applicable to all industrial areas, while others are relevant only to certain types of business. Examples of criteria used to measure size are: number of employees, volume/value of sales turnover, asset size, volume of deposits, total capital investment, total investment in plant and machinery and volume.

**Economic/Control criteria**- Size does not always reflect the true nature of an enterprise. In addition qualitative characteristics may be used to differentiate small business from other business. The economic/control definitions are:

* Market share-The characteristics of a small firm is share of the market is that it is not large enough to enable it to influence the prices of national quantities of goods sold to any significant extent.
* Independence-Independence means that the owner has control of the business himself. It therefore rules out those small subsidiaries which though in many ways fairly autonomous, nevertheless has to refer major decisions (e.g. on capital investment) to a higher level of authority
* Personalized management-PM is the most characteristics factor of all. It implies that the owner actively participates in all aspects of management of the business, and in all major decision-making processes. Therefore is little devolution or delegation of authority.

A business is small if the owner has direct line of communication with the operating managers and has personal contact with a large operation of the work force including key persons, individually owned and operated business and a business employing not more than fifty people.

|  |  |  |
| --- | --- | --- |
| Country  | Category of industry  | Criterion  |
| Australia | Manufacturing service  | <100 Employees<20 Employees  |
| Germany | SME | <500 Employees  |
| France | SME | 10- 499 Employees  |
| Japan | Manufacturing  | <200 Employees  |
| Canada | Manufacturing  | <200 Employees |
| USA | Very small Small Medium  | <20 Employees1. -99 Employees

100 - 499 Employees  |
| China | SME | Depends on product group, usually 100 employees, investment ceiling US $8 million. |
| Indonesia | SME | <100 Employees |
| Malaysia | SME  | <175 workers. Investment US$ 1 million  |
| Thailand | Labor intensive Capital Intensive  | <200 Employees <100 Employees  |

Even if the legal definition of SMEs varies from country to country, According to the new Small & Micro Enterprises Development Strategy of Ethiopia the working definition of MSEs is based on capital and labour0 as follows.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **NO** | **Enterprise level** | **Sector** | **Hired labour** | **Capital** |
| 1 | Micro | Industry | < 5 | <Birr 100,000.00 |
| Service | < 5 | <Birr 50,000.00 |
| 2 | Small | Industry | 6-30 | <Birr 1,500,000.00 |
| Service | 6-30 | <Birr 500,000.00 |

**2.1.2 Importance of Small Business**

Small businesses survive and prosper for many different reasons:

* **Developing personal relationships** - small businesses are well placed to build personal relationships with customers, employees, and suppliers. With a small business you know who you are dealing with; you can 'put a face' to the person you are in contact with. Person-to-person interaction is as important as ever in building strong relationships.
* **Responding flexibly to problems and challenges** - in a small business there is little hierarchy or chain of command. Large businesses may have set ways of operating and establish procedures that are hard to change. Small businesses are often far more flexible. It can also reach a quick decision on whether or not it can do what is required.
* **Inventiveness and innovation** - small businesses are well positioned to introduce and develop new ideas. This is due to their owners not having to report or seek approval from anyone else. For example, when Anita Roddick set up The Body Shop, she developed a range of environmentally friendly cosmetics in unsophisticated packaging. This would have been frowned on in a conventional cosmetics company.
* **Low overheads** - due to the small scale of operation, small businesses have lower overhead costs. They operate in small premises with low heating and lighting costs, and limited rent and rates to pay. Low costs result in lower prices for consumers.
* **Catering for limited or niche markets** -large firms with high overheads must produce high levels of output to spread costs. By contrast, small firms are able to make a profit on much lower sales figures. They can therefore sell into much smaller markets: e.g. a local window cleaner serving a few hundred houses, a specialist jewellery maker with personal clients.

NB. The main reason many people choose to set up a small business, is because it gives them independence. They also reap the rewards for themselves; these are two powerful incentives.

**2.3 Small Business Failure Factors**

* **Choosing a business that isn't very profitable.** Even though you generate lots of activity, the profits never materialize to the extent necessary to sustain an on-going company.
* **No Business Plan-** Knowing what your business will be and how you will sell your products or services are not enough to keep it running. You need to have a business plan written out, including (but not limited to) the following:
* your short and long term goals;
* the business’ finances for labor, production equipment, etc.;
* your target markets
* Marketing.

Having one which outlines every detail will guide your business to the right path.

* **Reactive attitudes**- Failure to anticipate or react to competition, technology, or marketplace changes can lead a business into the danger zone. Staying innovative and aware will keep your business competitive.
* **Inadequate cash reserves.** If you don't have enough cash to carry you through the first six months or so before the business starts making money, your prospects for Success are not good. Consider both business and personal living expenses when determining how much cash you will need.
* **Failure to clearly define and understand your market, your customers, and your customers' buying habits.** Who are your customers? You should be able to clearly identify them in one or two sentences. How are you going to reach them? Is your product or service seasonal? What will you do in the off-season? How loyal are your potential customers to their current supplier? Do customers keep coming back or do they just purchase from you one time? Does it take a long time to close a sale or are your customers more driven by impulse buying?
* **Failure to price your product or service correctly.** You must clearly define your pricing strategy. You can be the cheapest or you can be the best, but if you try to do both, you'll fail.
* **Failure to adequately anticipate cash flow.** When you are just starting out, suppliers require quick payment for inventory (sometimes even COD). If you sell your products on credit, the time between making the sale and getting paid can be months. This two-way tug at your cash can pull you down if you fail to plan for it.
* **Failure to anticipate or react to competition, technology, or other changes in the marketplace.** It is dangerous to assume that what you have done in the past will always work. Challenge the factors that led to your Success. Do you still do things the same way despite new market demands and changing times? What is your competition doing differently? What new technology is available? Be open to new ideas. Experiment. Those who fail to do this end up becoming pawns to those who do.
* **Overgeneralization.** Trying to do everything for everyone is a sure road to ruin. Spreading yourself too thin diminishes quality. The market pays excellent rewards for excellent results, average rewards for average results, and below average rewards for below average results.
* **Overdependence on a single customer.** At first, it looks great. But then you realize you are at their mercy. Whenever you have one customer so big that losing them would mean closing up shop, watch out. Having a large base of small customers is much preferred.
* **Uncontrolled growth.** Slow and steady wins every time. Dependable, predictable growth is vastly superior to spurts and jumps in volume. It's hard to believe that too much business can destroy you, but the textbooks are full of case studies. Going after all the business you can get drains your cash and actually reduces overall profitability. You may incur significant up-front costs to finance large inventories to meet new customer demand. Don't leverage yourself so far that if the economy stumbles, you'll be unable to pay back your loans. When you go after it all, you usually become less selective about customers and products, both of which drain profits from your company.
* **Believing you can do everything yourself.** One of the biggest challenges for entrepreneurs is to let go. Let go of the attitude that you must have hands-on control of all aspects of your business. Let go of the belief that only you can make decisions. Concentrate on the most important problems or issues facing your company. Let others help you out. Give your people responsibility and authority.
* **Putting up with inadequate management.** A common problem faced by Successful companies is growing beyond management resources or skills. As the company grows, you may surpass certain individuals' ability to manage and plan. If a change becomes necessary, don't lower your standards just to fill vacant positions or to accommodate someone within your organization. Decide on the skills necessary for the position and insist the individual has them.
* **Bad Location-** It is not enough to set up a store at a location with high human traffic or with a very cheap lease. Opening a restaurant near a school campus can seem like a good idea, but don’t expect too many customers if the food is expensive and there are much cheaper alternatives around. You need to consider your target market and their habits, as well as the direct competition in the area. Don’t be afraid of spending on prime location, as the increased rate of customers coming into your store and making a purchase will make up for the initial cost.

**2.4 Problems in Ethiopia Small Business**

The promotion of MSEs is becoming a popular development tool. Accordingly, governments and donors in the developing countries have shown increasing interest in promoting innovations and entrepreneurship. They have initiated various support programmes with the aim to improve MSEs’ competitiveness through enhancing technology and innovation capabilities such as upgrading product quality, improving design and packaging, and training to improve competitiveness. Thus the government of Ethiopia developed a strategy frame work to create an enabling environment for MSEs. In addition it has the following specific objectives.

1. Facilitate economic growth and bring about equitable development

2. Create long-term jobs

3. Strengthen cooperation between MSEs

4. Provide the basis for the Medium and Large Scale Enterprises

5. Balance preferential treatment between MSEs and bigger enterprises

6. Promote export

But Most Ethiopian SMEs have not been able to contribute substantially as needed to the economic development particularly because of financial, product, and marketing problems. These problems are still major handicaps to their development. Lack of adequate finance and credit has always been major problem of Ethiopian small business. Small scale units do not have easy access to the capital market because they mostly organized on proprietary partnership bases and are of very small size. They do not have access to industrial sources of finance partly because of their size and partly because of the fact that their surpluses which can be utilized to replay loans are negligible. Because of their size and partly because of the fat limited profit they search for funds for investment purpose. Consequently, the approach moneylenders who charge high rate of interest hence small enterprises continue to be financially weak.

**2.5 Setting Small Business**

**2.5.1 What is Basic Business Idea?**

A business idea is the response of a person or persons, or an organization to solving an identified problem or to meeting perceived needs in the environment (markets, community, etc.) A good business idea is essential for starting a successful venture and for staying competitive afterwards. Finding a good idea is the first step in transforming the entrepreneur’s desire and creativity into a business opportunity. Good business ideas, however, do not usually just occur to an entrepreneur.

Business ideas are all around you. Some business ideas come from a careful analysis of market trends and consumer needs; others come from serendipity. If you are interested [in starting a business](http://sbinfocanada.about.com/od/startup/a/businesstype.htm), but don't know what product or service you might sell, exploring these ways of getting business ideas flowing will help you choose.

1. **Examine your own skill set for business ideas.**

Do you have a talent or proven track record that could become the basis of a profitable business?

Spoke to a man who had spent years

To find a viable business idea, ask yourself, "What have I done? What can I do? Will people be willing to pay for my products or services?"

1. **Keep up with current events and be ready to take advantage of** [**business opportunities**](http://sbinfocanada.about.com/od/businessopportunities/)**.**

Keeping up with current events will help you identify market trends, new fads, industry news - and sometimes just new ideas that have business possibilities.

1. **Invent a new product or service.**

Think back a years ago. Was there a huge demand for the product/service?

Look around and ask yourself, "How could this situation be improved?" Ask people about additional services that they'd like to see. Focus on a particular [target market](http://sbinfocanada.about.com/od/marketing/g/targetmarketing.htm) and [brainstorm ideas](http://advertising.about.com/od/creatingads/a/Tips-For-Successful-Brainstorming.htm) for services that that group would be interested in.

1. **Add value to an existing product.**

Putting a product through an additional process which increases its value, but additional processes are not the [only way value](http://sales.about.com/od/salesbasics/a/How-To-Add-Value-To-Your-Sales.htm) can be added. You might also add services, or combine the product with other products. For instance, a local farm which sells produce also offers a vegetable delivery service; for a fee, consumers can have a box of fresh vegetables delivered to their door each week.

1. **Investigate other markets.**

Some business ideas aren't suited to local consumption - but appeal greatly to a foreign market.

1. **Improve an existing product or service.**

An entrepreneur should create an improved version of product; There are very few products (or services) that can't be improved. Start generating business ideas by looking at the products and services you use and brainstorming ideas as to how they could be better.

**Generate Business Idea**

There are many reasons why entrepreneurs or would-be entrepreneurs need to generate business ideas. Here are just a few:

* You need a great idea to start a new business
* Business ideas need to [respond to market needs](Module%20for%20TOT.doc)
* Business ideas need to respond to changing consumer wants and needs
* Business ideas help entrepreneurs to stay ahead of the competition.
* Business ideas help entrepreneurs to stay ahead of the competition.
* Business ideas are needed to exploit technology and do things better
* Business ideas are needed because the life cycles of products are limited.
* Business ideas help to ensure that businesses operate effectively and efficiently.
* Business ideas help to solve natural resource scarcity, pollution and depletion.

**Sources of Business Idea**

* Hobbies/Personal Interests
* Personal Skills and Experience
* Mass Media (newspapers, magazines, TV, Internet)
* Business Exhibitions
* Surveys
* Customer Complaints
* Natural scarcities and pollution
* Changes in Society
* Brainstorming
* Being Creative

**2.5.2 Project Identification and Selection**

**Brainstorming**

Brain storming is a technique for creative problem-solving as well as for generating ideas. The objective is to come up with as many ideas as possible. There are four rules for brainstorming:

* Don’t criticize or judge the ideas of others
* Freewheeling is encouraged-ideas that seem to be wild or crazy are welcome.
* Quantity is desirable – the greater the number of ideas, the better
* Combine and improve upon the ideas of others.



**Screening Business Ideas**

 **1. Macro Screening Criteria (first stage screening)**

* Marketability,
* Availability of raw material,
* Ease of implementation,
* Financial ability of the entrepreneur, etc.

 **2. Micro Screening Criteria (Second stage screening)**

1. **Marketing Viability-** product, target market, size of target market, demand and supply situation, competition and marketing practices
2. **Technical Viability-** technology, source of technology, raw materials, infrastructure and facilities, location , skills and cost
3. **Organizational and Management Viability**- Abilities, competencies, skills, values and motivations of management/key officers as per the requirements of project and appropriate legal personality and organization.
4. **Financial Viability**- project cost, sources of financing and profitability

 **3. SWOT analysis**

* **Strengths**: Strengths are within the control of the entrepreneur and they occur at present. Strengths should be capitalized and harnessed to make weaknesses redundant.
* **Weaknesses:** Weaknesses are within the control of the entrepreneur; they occur at present. They are "lack of...", "missing...", or weak points. As far as possible, weaknesses should be eliminated**!**
* **Opportunities:** Opportunities are positive or favorable factors in the environment which the entrepreneur. They are, however, mostly beyond the control of the entrepreneur. They are different from strengths in the sense that strengths are positive internal factors of the business.
* **Threats:** Threats are negative or unfavorable external factors in the environment and normally beyond the control of the entrepreneur. They adversely affect the business, if not eliminated or overcome. Threats differ from weaknesses in as much as they are beyond the control of the entrepreneur. Both have a negative impact on the business.

**2.5.4 Steps in Setting a Small Scale Unit**

Starting a business involves planning, making key financial decisions and completing a series of legal activities. These 10 steps can help you plan, prepare and manage your business.

1. [**Write a Business Plan**](https://www.sba.gov/category/navigation-structure/starting-managing-business/starting-business/how-write-business-plan)- business plan is a guide line. This written guide will help you map out how you will start and run your business successfully.
2. [**Get Business Assistance and Training**](https://www.sba.gov/category/navigation-structure/counseling-training)-Take advantage of free training and counselling services, from preparing a business plan and securing financing, to expanding or relocating a business.
3. [**Choose a Business Location**](https://www.sba.gov/content/tips-choosing-business-location)- Get advice on how to select a customer-friendly location and comply with zoning laws.
4. [**Finance Your Business**](https://www.sba.gov/category/navigation-structure/loans-grants/small-business-loans/sba-loan-programs)-Find government backed loans, venture capital and research grants to help you get started.
5. [**Determine the Legal Structure of Your Business**](https://www.sba.gov/content/business-structure-and-tax-implications)-Decide which form of ownership is best for you: sole proprietorship, partnership, Limited Liability Company (LLC) or corporation. [**Register a Business Name**](https://www.sba.gov/content/register-your-fictitious-or-doing-business-dba-name) -Register your business name with your state government.
6. [**Get a Tax Identification Number**](https://www.sba.gov/content/getting-tax-identification-number)-Learn which tax identification number you'll need to obtain from the IRS and your state revenue agency.
7. [**Register for State and Local Taxes**](https://www.sba.gov/content/learn-about-your-state-and-local-tax-obligations)-Register with your state to obtain a tax identification number, workers' compensation, unemployment and disability insurance.
8. [**Obtain Business Licenses and Permits**](https://www.sba.gov/content/obtaining-business-licenses-permits)**-** Get a list of federal, state and local licenses and permits required for your business.