Management Skills for Small Business

A Report Submitted to
Small Business Policy Branch, Industry Canada

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The following is an unedited section of the above report made available by Industry Canada and which addresses research on the problem of deficiencies in SME. We are providing this information to assist in creating awareness of the statistics for SME as it relates to management skills business deficiencies. To this end, we are pleased to facilitate a complete version of this report to any interested party – please request a copy by sending us an e-mail at *info@dasaconsulting.ca*

3. The Problem

It is well-known that the small firm population is characterized by high rates of turnover: high birth-rates and high death rates are typical. Recent Statistics Canada data show that over two-thirds of micro-sized firms (less than 5 employees) and almost half of small sized firms (5-99) fail within five years of start-up. Nearly 80% of all new SMEs are gone within 10 years. Some would argue complacently that one should not be alarmed by such figures since they are not untypical of the experience of other countries and, in any case, survival of the fittest is the natural order of things. Needless to say, however, policy analysts have long recognized that if more small firms could be fitter their probabilities of survival would be enhanced. That is why, as will be shown later, public, private, and NGO efforts of various kinds are being used to address management skills difficulties in small firms. It is also why much recent policy research concentrates on the ingredients of success, as well as the reasons for failure (notably, Baldwin et al. 1994; Johnson, Baldwin and Hinchley, 1997; and Baldwin et al. 1997).

Evidence of Deficiencies

Evidence of deficiencies in Canadian management skills is presented in some detail in Newton (1995). To that list may be added some more recent findings.

- Porter et al. (2000) in *The Global Competitiveness Report 2000* rank some 59 countries on various criteria to construct a competitiveness index. On the factor of "competence of senior management" Canada ranks a modest 9th
- Similarly, the International Institute for Management Development (2000) in *The World Competitiveness Yearbook 2000* ranks Canada 9th of 47 countries on the overall management measure, but 13th on the specific dimension of managerial competence and 16th on international experience
- A survey in 2000 by the Information Technology Association of Canada (ITAC) of firms in the information technology sector on barriers to growth ranked "appropriate and effective management resources" second on a list of three gaps (the others being access to investment funding and adequate knowledge of sales and marketing)
- The Canadian Manufacturers and Exporters of Canada conducted a survey in 2000 on the management issues faced by its members (the majority of which are SMEs). Management skills were ranked first on a list of skill needs – before information technology skills and before engineering skills
- Also in 2000 the Certified Management Accountants of Canada conducted a survey of its members who are involved, or had been involved, with small businesses, either as employees or advisors. The top two factors of CMAs identified in SME failures were poor business planning and poor financial planning . In addition, they ranked "better knowledge of business skills" top on the list of SME needs. (CMA Canada: Briefing Notes to the Government of Canada)

Table 3: How important are the following needs of an SME from a business skill development perspective?

	Critical	Somewhat important	Not very important	Not at all important
Better knowledge of business skills	30%	59%	10%	1%
Resources to hire professional advisors	24	46	22	7
More staff training	17	53	26	5
A continuous learning philosophy	25	50	20	5

Source: CMA Canada

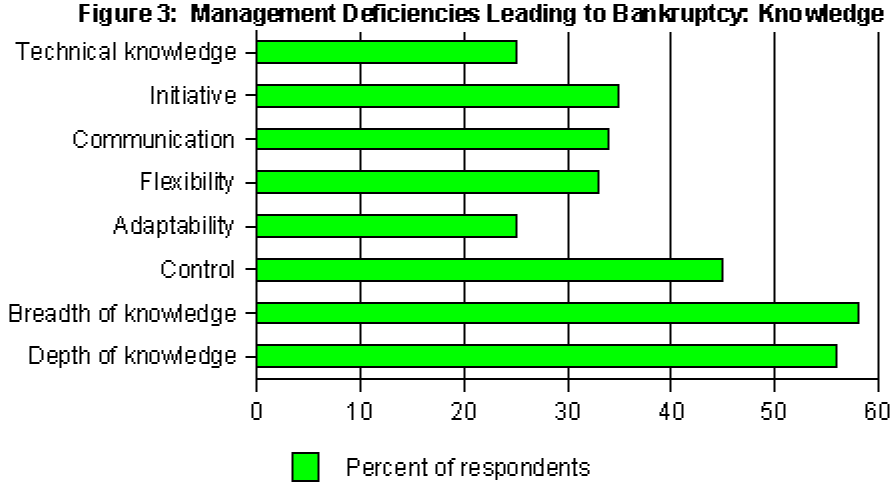
Of the recent empirical work one of the most telling pieces of evidence is Baldwin et al. (1997) which examines in detail the causes of business bankruptcy in Canada, using a sample consisting predominantly of small firms. Among the authors' principal conclusions are the following observations:

- Almost half of the firms in Canada that go bankrupt do so primarily because of their own deficiencies rather than externally generated problems. They do not develop the basic internal strengths to survive. Overall weakness in management, combined with a lack of market for their product, cause these firms to fail

- The main reason for failure is inexperienced management. Managers of bankrupt firms do not have experience, knowledge, or vision to run their businesses. Even as the firms age and management experience increases, knowledge and vision remain critical deficiencies that contribute to failure
- The management of new firms face a learning curve. In the early stages of life, internal deficiencies are so prevalent that most bankruptcies occur for these reasons. Management must master the basic internal skills – general and financial knowledge, control, communications, supervision of staff, and market development – or it will fail solely or primarily from the weight of these problems. As a surviving business grows, a new set of problems arise that are associated with the increased complexity of running an older and often larger firm. Managerial issues such as the poor use of outside advisors, lack of emphasis on quality, and unwillingness to delegate responsibilities, departure of key personnel, and personal problems associated with the owner/manager become relatively more important factors contributing to failure as a firm ages. (From Baldwin et al.: Failing Concerns, 1997)

Strong management skills had already been identified as critical for growth in Baldwin et al's (1995) *Strategies for Success* and again in Baldwin et al's (1997a) as the crucial means to survive and emerge into thirteen years. The latest findings (Baldwin et al. 1997) in *Failing Concerns* further substantiate this story: in 71% of the failed firms, deficiencies in both general and financial management are described as the major causes of failure – the single most important internal causes of bankruptcy, ahead of marketing (50%), production/operations (30%), innovation (28%) and HR (27%). This general conclusion is supported with reference to three specific areas of management skill deficiencies.

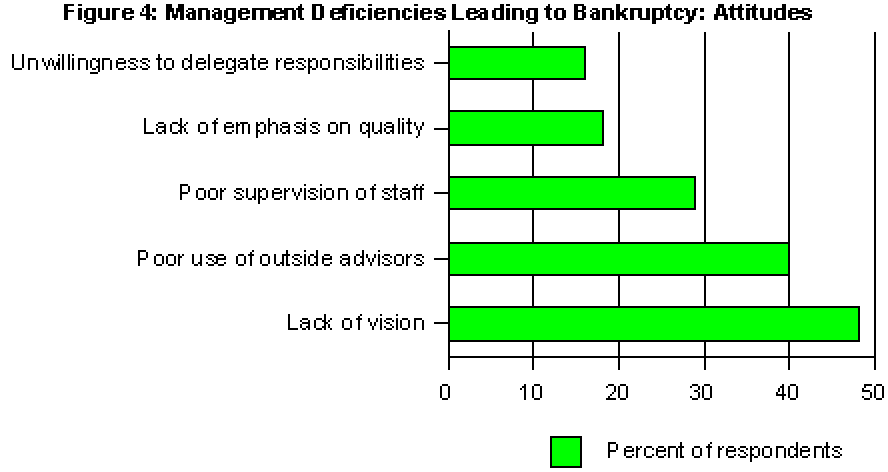
Figure 3: Management Deficiencies Leading to Bankruptcy: Knowledge



As shown in figure 3 bankruptcies occur mainly because of lack of both breadth and depth of knowledge on the part of management, and the authors contend that this was particularly so in the areas of financing, marketing and operations. White technical knowledge was somewhat less of a failing, lack of control (due to management inexperience) was cited as a factor by 45% of respondents and management deficiencies in adaptability, flexibility, communication, and initiative were identified as sources of failure by about one quarter of failed firms.

The results presented so far begin to hint at the importance of "soft skills" and this is further strengthened with reference to figure 4, which depicts management deficiencies relating to attitudes and characteristics. While quality was seen as crucial for growth and survival in the earlier studies by Baldwin et al. (1994) and Johnson et al. (1997) it is a cause of failure in only 17% of bankruptcies. Nor was management's unwillingness to delegate responsibility deemed to be a factor, though it is apparently more of a factor for firms in the smaller size category (1-9 employees).

Figure 4: Management Deficiencies Leading to Bankruptcy: Attitudes



While lack of knowledge was shown to be a major problem, this was often not recognized and responded to: failed firms neglected to avail themselves of the services of outside professionals to fill the knowledge gaps. Staff supervision and lack of control appear to be problems that increase with firm size.