PROBLEMS OF ORGANIZATION IN SMALL BUSINESS

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INTRODUCTION

Interest in small business has grown and expanded enormously during the last few decades, and the number of articles and books on the subject has increased greatly. But interests are varied, and the expression «small business» means different things to different groups. Opinions and attitudes also vary widely because of the diversity of concepts found in the term.

If we try to analyze the business world we see that it is made up largely of small businesses. In fact, there are very few large businesses if we consider the total number of stores, plants, offices, farms, and other enterprises. But the large business attracts more attention.

The desire to start a business is a human and natural one. To be an independent business operator is the inherent desire of millions of people in every land.

Some business can never become large, for example many service concerns. Others start small in order to introduce a new idea, or a new product or service. They may grow or they may fail, according to the different conditions. Every year thousands of people start a business with their accumulated know-how, capital, and judgment in search of the income and independence they believe to be associated with going business for one's self. However, statistics show that a large number of new businesses are relatively short-lived. In a highly competitive market poor judgment, lack or ability in management bring fast reaction. The trouble usually lies in the new owner-managers' limited preparation, lack of administrative experience, and failure to apply the easily understandable principles and methods of business opera-
tion which have always characterized the successful firm. Many persons who know their jobs do not know the businesses of which those jobs are a part. (1)

Definition of Small Business. As mentioned before it is rather difficult to define the «small business». To make it clear we shall give different definitions of various institutions and try to formulate the common points in these explanations. In Small Business Act of the United States, in section three, small business is defined as:

For the purpose of this Act, a small-business concern shall be deemed to be one which is independently owned and operated and which is not dominant in its field of operation. In addition to the foregoing criteria the Administrator, in making a detailed definition may use these criteria, among others: Number of employees and dollar volume of business. Where the number of employees which a small-business concern may have under the definition shall vary from industry to industry to the extent necessary to reflect differing characteristics of such industries and to take proper account of other relevant factors. (2)

As seen from the definition in Small Business Act, the interpretation is left to other agencies of government. The Department of Commerce in the United States identifies the small manufacturer by an employee population of fewer than 100, the small wholesale by a sales volume of less than $500,000, and the small retail and service firm by receipts under $100,000. The Bureau of Labor Statistics finds average figures for a number of industries and terms those below the average «small». The Securities of Exchange Commission, among others, has defined small business in terms of assets; most frequently, $250,000 is the dividing level. Still other experts have used net income, usually about $25,000 or less, in their measure. Definitions formulated by the Small Business Administration stress nondominance in the field but larger quantitative measures. (3)

It is better to keep in mind the rule of thumb employed by the Committee for Economic Development in the U.S. A small business, the Committee holds, typically will meet two or more of the following specifications:

1. Management is independent. Usually the managers are owners.
2. Capital is supplied and ownership held by an individual or small group.
3. Area of operations is usually local, with one plant and home office, although its market need not be so.
4. Size within the industry is relative; the business is small when compared to the biggest units in its field. The size of the top bracket varies greatly, so that what might seem large in one field would definitely be smaller in another. (4)

In short, «size» is a matter of opinion. And in many areas it determines the size of the business rather than any other physical or financial yardstick.

At the XIIth International Congress of Scientific Management in Melbourne, in March, 1960, the National Development Foundation of South Africa was made responsible for «Management Problems of Small Business». In the report prepared by this foundation the small business characteristics are summarized as:

1. The equity capital must be supplied by the owner-managers who are also responsible for management.
2. It must have reached the stage where some delegation of management responsibility has taken place.
3. It must have reached a stage where the owner-manager can no longer reasonably have a personal knowledge of all his employees. (5)

This definition so far eliminates one-man business, companies in which the public is substantially interested financially,

and small concerns which are subsidiaries of much larger concerns elsewhere.

The International Industrial Development Center at Stanford Research Institute has undertaken a program of research on small industry development. Relevant materials from all over the world are being collected and analyzed. In this report small business characteristics stated as:

1. Little or no specialization in management.
2. Close personal contact of the manager with third persons.
3. Lack of access of capital through the organized securities market.
4. No dominant position in a major product market.
5. Often, a relatively close integration with the local community.

In the report as their view, based on observations in many countries, it is stated that the manufacturing establishments with less than 100 employees generally exhibit some of the functional characteristics mentioned above. Beyond this zone the characteristics are associated with medium and large industry. (6)

As seen from the different explanations the characteristics vary in significance depending upon the particular problem involved. In this paper the management concepts aimed at the type of concern that closely fits the Committee for Economic Development pattern.

Role of Small Business in Economy. Small business operations are far more important to the economy of different countries than one may think. Throughout most of the world small business is representative of the economy of its nations. Handicraft shops, laundries, bakeries, footwear, houseware, blacksmith and general repair shops are fair examples, as they have been for centuries. The family enterprise tends to be dominant in many countries. However, the emphasis on the importance of small business does not imply an underestimation of the contributions of big business. Small and big business have their place and are interdependent.

In the United States, the Department of Commerce counts some four million enterprises of which 95 percent have fewer than 20 employees. Even among manufacturers, three out of four employ fewer than 20 people and are therefore quite small indeed. (7)

The supporters of small business often pictures small concerns as powerless victims of big business cooperations that are gradually taking over the economy. To understand the truth or the error of these views, it is necessary to examine the trend of small business in recent decades. An analysis of the number of business units in proportion to population reveals some fluctuations but no definite trend toward the decrease in the number of businesses. (8)

The forms of small industry found in the highly industrialized economies are very different, however, from those in traditional economies. Most small factories in the United States are modern in the sense that they use reasonably up-to-date tools, equipment, and methods. In the table below the percentage of manufacturing output produced by small manufacturing establishments in the United States is very close to manufacturing employment. The same holds for West Germany. For Japan the situation is greatly different. There, the 56 percent of manufacturing employees who work in small establishments produce only 34 percent of manufacturing output. For this reason average pro-

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(7) Marting, Elizabeth, op. cit., p. 16.
ductivity per Worker is considerably less in small establishments than in large, reflecting lower capital investment per worker, less advanced technology, and less efficient management. (9)

There is, certainly, much in common between even the smallest firm and the largest. Both exist in the same economy and share many problems and responsibilities. Managers of both have a five-way responsibility to their businesses or stockholders, to their customers, to their employees, to the general public and to the government. Large firms depend upon their smaller associates as suppliers of materials and parts, as service agencies, as dealers, as distributors, as retailers, and even as customers. In return, the small business can help the big corporation to concentrate on specific areas. (10)

As a country moves to more modernized economy the character of its small industry will change. In short, its artisan industry will be transferred, its household industry will be replaced and small but modern factories will be developed. Planners designing a small industry program for a particular country should not model it on that of any other country. Ideas from many countries should be considered, some of them to be taken over with appropriate adoption.

Operational Advantages of the Smaller Firm. Some of the very real advantages of smaller firm are operational in character. These can be inventive and experimental serving as a proving ground for new ideas and products, for new services, for new materials that a large corporation is unable or unwilling to try. In this case the manager may not only follow the market but can anticipate it. He can often prove the new concept in practical terms, without need of major capital investment or development of market. Research and development through daily operations is obviously more realistic than testing in laboratories. It is more risky and in a large company may cause heavy loss. But small business, which is more flexible can handle it on limited scale. This flexibility is another superiority of smaller operation. It can give accurate and swift attention to detail, whether required by

(10) Marting, Elizabeth, op. cit., p. 17.
diverse product or diverse demand. The small business can adopt itself to the changing conditions in market in short time.

It is in advantageous position in certain instances to large ones in lower overhead and in freight-costs because of selling areas near the plant. It is also free in time-consuming planning and coordination that is «must» in mass production. Specialized marketing is another area in which the smaller company may prove its superiority, for example in cases where raw materials or end products are perishable, where the market is local, or where it is specific and limited. When a product or service requires close supervision and personal participation on the part of top management the smaller firm has a very real advantage. Also small firm can have better coordination and communication since it is controlled by relatively few people. (11)

It is true that technological considerations justify big business institutions in some industries. In steel and auto manufacturing production facilities must be sizable, requiring large amounts of capital. The technology factor, however, does not apply with equal force to all industries. Mass production requires mass markets but a limited or specialized market may be best served by a small business. Geography and product specialization both provide special, limited markets effectively served by small business concerns. (12)

PROBLEMS OF SMALL BUSINESS

It is clear that many of the problems facing the small businessman are also present in large undertakings. The manager of a small business, however, must approach his problems differently. In practice the main difference being that the small businessman must find a solution without the aid of teams of resident experts, and in many cases he must find solution quicker than his counterpart, since his reserves are not so great. It is not surprising that the solutions to the problems may also, differ. In spite of the differences it is probable that the solution which big business has found to any given problem may well represent the ideal solution to the small businessman. A useful first step

(11) Ibid., pp. 18-20.

150
in the study of any problem, therefore, may be to find out how the big business has faced it, and assess whether the same solution in modified form, is practicable.

The problems of small business are analyzed differently by several writers. Some classified the problems in two categories as (a) problems characteristic of most small business because of the type of individuals who frequently enter these fields, and (b) problems resulting from conditions at any period of time, such as laws unfavorable to the small business. (13) Others classified as (a) personal lack and misuse of time, (b) personal lack of specialized management skills, (c) other problems such as insufficient training and experience of managers, difficulty in hiring and retaining the management help needed and so on. (14) We shall try to summarize the problems of organization and try to show the similarities and differences with the large organizations in this paper.

**PROBLEMS OF ORGANIZATION**

Good organization is essential to the success of any enterprise. No business can afford to have poor organization, with its consequent wastes of manpower and resources, and the smaller company can afford these wastes less than the larger one.

A business organization is a group of people, each with special functions assigned, who are joined together for the purpose of business operation at a profit. The definition would be applicable to a small business organization as well as to the largest concern.

One of the difficulties in gaining significant information about small business practices is the lack of agreement on any definition of small business which is mentioned before in the definition of small business. (15) The basic general premise concerning business organization has been stated as follow: The organic business functions (production, marketing, and finance in an or-

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151
ganization) are performed in the very small firm by a single individual, the owner-operator. Increasing business volume brings a separation of these functions one from the other; and the managerial tasks of planning, organizing, and controlling are separated from the purely operative tasks. As the managerial duties increase in volume and become more complex, accounting, production planning and control, market research, personnel and other functions are given separate organizational status to facilitate the work of the managerial personnel. Furthermore, some staff functions have greater growth with increased business volume than others and are therefore held to be more likely to be differentiated first. The small organization does not have and cannot afford large-scale staff activity in many areas and therefore relies heavily on committees to carry out functions normally assigned to specific staff groups in the large firm. (16)

Almost any authority in the field of business would attach considerable importance to «good organization». In this part of the paper we shall examine the nature, principles, and values of an organization to the small business concern. Attention will also be devoted to the matter of staffing the small firm.

Nature and Importance of Organizing the Small Firm

The task of organizing rests on the cornerstone of a business mission to be accomplished. The details of organizing, in turn, include the breakdown of this over-all objective into related assignments. Such an organization plan is needed to carry out the business mission, to give direction to the people assembled, and to coordinate their efforts.

The starting point in organizing for effective management action is the objectives of the firm. These define the purpose for which the firm was established. Where it has multiple objectives, they should also indicate the order of relative importance. Every action must be consistent with the area of organization, suggest the function which are basic to the firm’s success.

Early in the growth of a business, organizational problems thrust themselves on the owner-manager. He has a small group

of executives to whom he has given general directives on their functions at the time of their appointment. He is certain to find, however, that these directives - usually given verbally in a small business - leave certain gaps, give rise to overlapping or are misinterpreted.

Viewed most broadly, the process of organizing includes provision of physical facilities, personnel, and capital. The major emphasis here is upon bringing the business functions, facilities, and personnel into a proper relationship with each other. In other words, assuming the existence of the necessary resources, the businessman's remaining task in organizing is the development of an organization structure.

In the process of organizing the businessman must constantly realize that he is organizing the work of people. Organizing cannot be accomplished satisfactorily by adoption a text-book formula for organization without regard to the particular individuals involved. In fact, it is the effective and coordinated performance of individual employees that constitutes the purpose of creating the organization structure.

In organizing, the problem of a choice of organization type is a relatively simple one. The only two practical alternatives for most small firms are the line organization and the line-and-staff organization. In line organization each person working in the organization has one supervisor to whom he looks for instructions and orders and to whom he reports. Also line-and-staff organization is similar to line organization in that each worker reports to single supervisor. However, there are also staff specialists who act as management advisors in special areas. The decision as to which of these two types should be utilized can usually be made on the basis of the company's size.

Even in the small organization, informal relationships arise among employees. Although such informal relationships do not constitute a part of the formal organization, they should be understood by the entrepreneur and evaluated as to their effect on the functioning of the total organization. (17)

In deciding what form of organization to adopt, several aspects should be considered. Since each has both advantages and

limitations, a good plan is to weigh these in the light of one's needs and objectives. At least the following aspects deserve consideration: (1) A need for additional funds may sometimes be met better by forming a partnership or corporation than by borrowing or using mercantile credit. However, either of the forms of organization means sharing profits as well as risks and losses. (2) A need for certain managerial abilities or experience may be met by taking in one or more partners possessing the requisite qualities. (3) The choice of organization form to use may be influenced by the desire to achieve such objectives as limiting liability, distributing the risks involved, and taking advantage of the tax structure in operation at the time and place where the business is to be started. Income tax laws may make one form of organization superior to others for the small businessman. Sometimes one form of organization is given advantages by particular laws or regulations. As the best form of organization to use, the final decision will probably be a compromise based upon weighing the relative importance of certain needs against the limitations of each suitable formal organization. The person in business must be familiar with these pros and cons for his own welfare and protection in order to take full advantage of his rights and at the same time avoid undesirable consequences due to his ignorance of his exact status.

Basic Factors in Structuring a Business Organization. Organization should be viewed as a dynamic process. The small firm and the business environment are both changing rapidly, and there is an almost inevitable impact upon the organization structure. The organization structure and its component positions must be constantly evaluated to see whether the firm's growth may have created a need for change in either or both. Where changes are justified, they should be made promptly in the structure itself.

Ernest Dale, in his book «Planning and Developing the Company Organization Structure» identified numerous stages in the growth of a firm at which certain organizational problems tend

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to be dominant. For example, formulation of objectives and division of work are held to be problems regardless of size. According to E. Dale, one stage of company growth may appear within the size definition limits set by the Small Business Administration. These stages include problems in (1) delegating responsibility and authority when the firm reaches ten employees, (2) delegating additional managerial functions when the employees number fifty to one hundred, (3) reducing the executives burden when employees number from fifty to three hundred persons, (4) creating the staff specialist when there are from one hundred to four hundred employees, and (5) turning to coordination of management functions through committee action when employees total one hundred to five hundred. (20)

Simplicity in organization structure will contribute to both understanding and efficient performance of the organization. Maximum performance cannot be approached, much less reached, if the organization structure is not understood completely by all members. It is not enough that the manager himself understand the organization structure. Consequently, the simpler the organization structure, the less the chance for organization friction, and the greater the sum total of achievement because of more effective performance by each individual in the enterprise.

Authority and responsibility should be delegated to the lowest level of the organization at which the particular responsibility can be discharged. To obtain the maximum benefit from good organizing, it is necessary to delegate as far down in the organization structure as possible the power to carry on the various activities essential to the firm’s success. The manager of a small business may question the possibility of delegating authority and responsibility in his own firm. The small business is even more burdened with detail than his counterpart in the large organization. He must delegate if he wishes to get the total job done efficiently. He may not be able to delegate as much as he would like, but he must delegate as much as he can. In deciding what duties should be delegated factors such as the following require consideration: size of the enterprise, legal form of or-

ganization, abilities of available personnel including top management, legal responsibilities and possible penalties involved, purpose or justification for the enterprise, current conditions, and possibly others in certain cases.

The number of subordinate positions directly accountable to a manager should be that number which best balances the essential subordinate activities, the abilities of the superior, and the communications and expense aspects of the situation. In the smaller firm, it is likely that there will be a somewhat larger span of control than in the larger organization. This is because the smaller firm cannot afford the layers of administrative salaries and other costs that go with reduced spans. Also, the span of the manager of a small business tends to increase without his being consciously aware of it. Span of control actually is a variable depending upon a number of factors. Among these are the nature of the work and the entrepreneurs' knowledge, energy, personality, and abilities. In addition, the abilities of subordinates should be considered.

Authority and responsibility should be equal in any position. In a small firm, this means that the manager may delegate a given amount of authority to his subordinates and they hold them responsible to the exercise of that authority. The difficulties encountered in defining precisely what the authority of a position is will make it virtually impossible to make sure that authority is delegated to a position in accordance with the responsibilities assigned. Despite these difficulties, every effort should be made to provide authority proportionate to the responsibilities of each position. (21)

Effective Use of Directors in Small Business. Since competent guidance, diversified business experience, and financial support will be required from the board in constant and varying degree, it is obvious that most serious consideration must be given to the selection of the directors. Such consideration must relate to their background and experience with the type of industry and products, as well as to their individual reputation, integrity and compatibility.

Marting, Elizabet, op. cit., pp. 48-52.
A large holding of the corporation’s stock should not be the only criteria for selection of a director. It is necessary to find persons of proper qualification who are both interested in serving as a director and capable of providing a portion of the initial equity capital.

The size of the Board of Directors will depend upon many factors, but principally upon (a) the scope of operations, (b) the amount of capital, and (c) by what means the capital was obtained. It is generally considered that at least five directors will provide a more useful minimum sized Board, permitting a greater cross section of opinion and diversity of experience than will three.

It is unfortunately true that in many small corporations the Board of Directors is not used to fullest capability, particularly in regard to establishing growth policies and developing a competitive position. This situation arises primarily because the individual directors either (1) do not get the opportunity to present their studied opinions, (2) do not wish to present their views because of a lack of familiarity with the product and its related problems, or (3) are not qualified to be corporate directors in the first place. It is true that the third cause is the most prevalent among small corporations. Management must be constantly aware of this failing when selecting directors. (22)

**Staffing the Organization.** Staffing is of crucial importance to the small firm. The problem of assembling an initial staff, with major emphasis upon filling managerial and supervisory positions, needs broad consideration. There is always a risk in hiring subordinates in the small business. The large firm can draw upon a wider market, can sometimes compete better in terms of salary and fringe benefits, so can procure able men more readily. Each key employee of the small firm assists in executive decision making and thus influences the future of the small concern. This means that the entrepreneur must plan wisely and utilize all available aids to effective selection of subordinates.

The small business is usually limited geographically in recruiting employees and is sometimes further handicapped by the fact that the best local talent may prefer employment in big business as mentioned above. The manager's effort must be to cause his plant or store to be considered «a good place to work».

Another point of special importance to the small business is to seek out and select candidates rather than wait for applications. Under any circumstances when applications for employment are received, standard employment procedures should be followed.

The reputation a small business acquires in the community is closely associated with its employee relations. Customers are guide to sense employees' attitudes toward their management. A contended well-treated staff of workers will reflect loyalty and enthusiasm in their dealings with customers and with public. Good employee relations therefore can be a major asset to the small business. Thus, good employee relations are an essential to good public relations. (23)

Rating the Organizational Setup. The basic factors of organization discussed under the heading of «Problems of Organization» might serve as check points. There are many practical tests of organizational effectiveness. One evidence of poor organization is failure to take action when action is needed. Such a failure may arise from poor organizational planning and failure to define an individual's responsibility and authority. A second evidence of inadequate organization is delay in necessary action. This may characterize the entire organization. Other organization weaknesses may be indicated by lack of sufficient effort on the part of individuals making up the organization. This may result from improperly defined responsibility or from creation of too many levels of management in the small enterprise. (24)

In an article published in «Business Week», it is stated that «what small businessmen don't know about the rudiments of financial controls and accounting would fill a business bookshelf. These show he is surprisingly ignorant of accounting and finan-

cial controls.» This is true for all other organization weakness also. (25)

CONCLUSION

Although there is no best way to organize a business under all conditions, great care should be exercised in determining the form of organization that best suits the particular circumstances. Personalities and attitudes as well as character and ability play a large part in determining the success of a business. All the considerations reviewed here are closely related to other management practices which are outside the scope of this paper. Small business is a field where there are a lot of things to study, especially in economically underdeveloped countries.

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