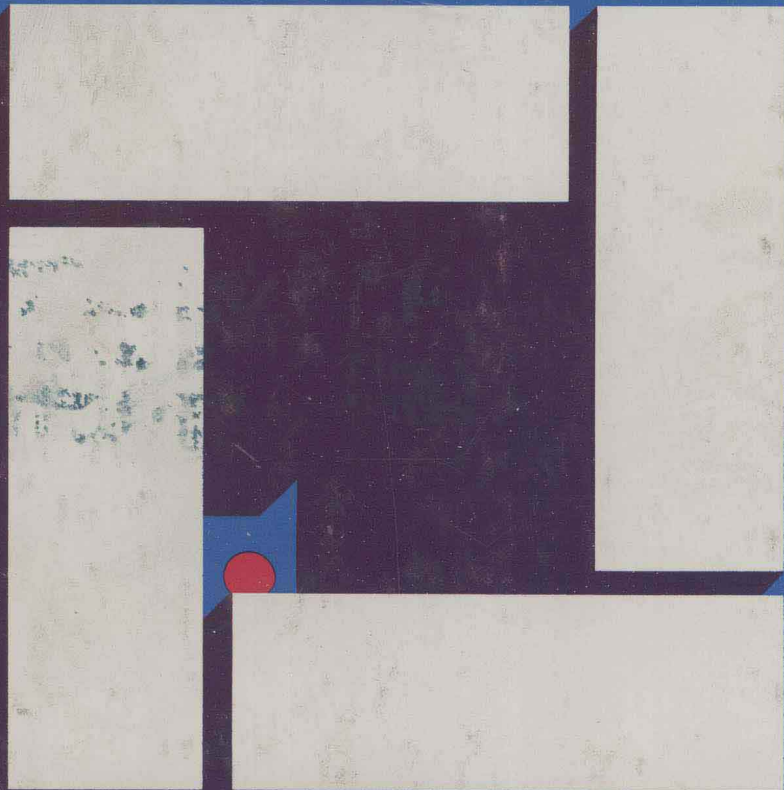


# SMALL BUSINESS MANAGEMENT

BROOM · LONGENECKER / FOURTH EDITION

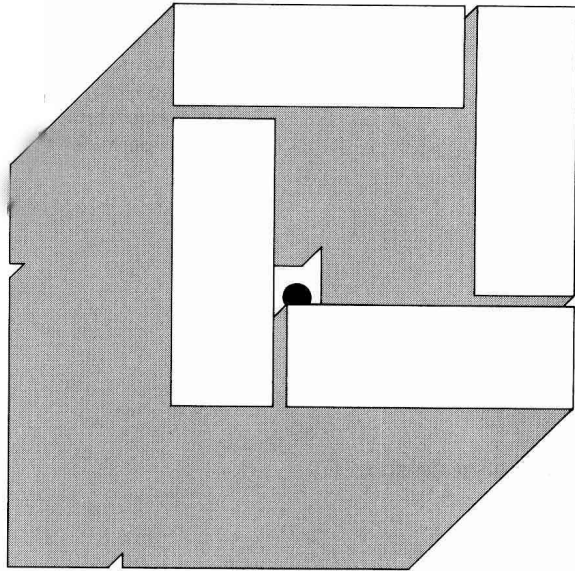


# SMALL BUSINESS MANAGEMENT

FOURTH EDITION

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## **PREFACE**

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Small business firms constitute an important part of today's business system. The role of small business in our economic history, moreover, has been one of distinction and contribution. Although its relative importance has declined with the growth of big business, small firms in the 1970s are still making a major contribution to American economic life.

In a rapidly changing economic and social environment, managers of small business firms must anticipate and adjust promptly to significant shifts in customers' demands, competitors' actions, and public expectations. The issues of business strategy and social responsibility are crucial, therefore, in the management of a small enterprise. Although environmental change creates problems, it also creates opportunities. In every community, well-managed small firms are following strategies that enable them both to prosper and to contribute to the public welfare.

Improving the quality of small firm management will strengthen an important sector of the economy and also contribute to the success of individual firms. It is for this reason that the primary focus of this book is upon effective management of small business firms. The management process includes not only strategy determination but also the varied activities necessary in planning, organizing, actuating, and controlling small business operations. In each area the emphasis is placed upon those aspects of management that are uniquely important to small firms.

Text material has been updated and rewritten in this fourth edition. As one example, the text now includes an expanded treatment of business strategy and the process of strategic planning for small firms. This new edition also reflects current pressures of environmentalism, consumerism, and other issues of social responsibility. Fourteen new cases provide additional opportunities for student

analysis of current problems and experience in decision making. The cases are diversified in character and portray a variety of administrative problems in many different business contexts.

Some chapters have been rearranged to provide a more orderly coverage of subject matter. In Part A we take a broad view of small business by considering its role in the American economy and the general patterns of success and failure. We then examine the basic management and business functions of small firms in Part B, and in Part C we deal with the processes involved in initiating new ventures. In Parts D and E we focus upon the areas of marketing management and financial management of the small firm; then we discuss its legal and governmental relationships in Part F. In the concluding section, Part G, we treat the problems involved in managing specific fields of small business such as a retail store, a franchise, a service firm, and a production plant.

In preparing the Fourth Edition, the authors have been aided by both students and colleagues. Small business owners have likewise been generous in providing raw materials for case problems. Among those assisting in supplying and interpreting case materials were J. R. Closs, Homer I. Longenecker, Mike McNamara, Parnell McNamara, Jr., Greg Smith, Johnnie R. Stewart, Nelson H. Sullivan, and Clair D. Weller. Credit lines on a number of cases show that they were prepared by other writers; we are indebted to them for permission to use these cases. In particular, we appreciate the opportunity of using cases prepared by our Baylor colleagues: Dr. Alan N. Cook, Professor Carlos W. Moore, Dr. Curtis C. Reiersen, Professor John E. Schoen, Dr. Richard C. Scott, and Dr. J. Clifton Williams. Dr. Burke A. Parsons, Director of Business and Economic Research, Baylor University, helped us locate sources of current business data; and Dr. Emerson O. Henke, our Dean, extended cooperation in various ways. Thanks are also due to our student assistant, Cindy Childs, who helped in typing and editing the manuscript. Finally, we gratefully acknowledge the understanding, cooperation, and contributions of our wives, Norma and Frances, to the completion of this book.

**H. N. Broom**

**Justin G. Longenecker**

January, 1975  
Waco, Texas

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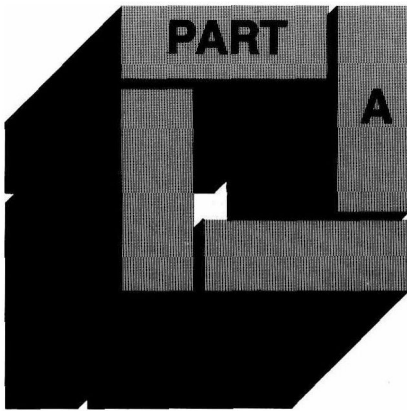
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# **The Environment for Small Business Entrepreneurs**

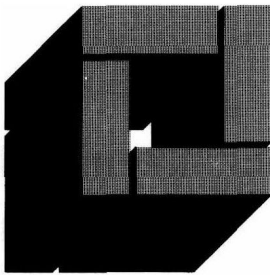
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## **CHAPTER**

- 1** Small Business in the American Economy
- 2** The Strengths and Weaknesses of Small Business
- 3** Strategy, Objectives, and Responsibilities of the Small Firm
- 4** Salaried Employment vs. Entrepreneurship
- 5** The Danger of Small Business Failure

## **CASE**

- A-1** Texas Meter & Device Company
- A-2** Acme Electro-Video, Inc.
- A-3** Nikipoulis Grocery Store
- A-4** Giving Jerry the Business
- A-5** Midwest Restaurant



# 1

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## Small Business in the American Economy

---

Business in the United States today includes a mixture of both large and small firms. In many industrial areas, big business is clearly dominant. Small business institutions are dwarfed by such giants as General Motors with three-fourths million employees; Bank of America with deposits of \$29 billion; Sears, Roebuck with sales of \$10 billion; Prudential Insurance Company with \$168 billion life insurance in force; and American Telephone and Telegraph Company with an annual profit in excess of \$2 billion. Because of the greater visibility of big business, we tend to overestimate its importance and to underestimate the contributions of the less conspicuous small firms which are indispensable to the functioning of our economy.

Before we assess the significance of small business in various segments of our economy, let us look at the various criteria set forth in an attempt to arrive at an explicit definition of small business.

### STANDARDS USED IN DEFINING SMALL BUSINESS

The same business may be described as "small" when compared to larger institutions and as "large" when compared to smaller firms. What is "small" depends upon one's point of view. Most observers would classify an independently-owned service station, restaurant, or retail store as a small business. Similarly, most would agree that the major automobile manufacturers are big businesses.<sup>1</sup> In between, however, are firms that may be considered large or small depending upon one's criteria and point of view. An explicit definition of small business is necessary for inclusion in legislation, for research purposes, and for reasoning intelligently concerning problems of the economy.

This raises the question, then, as to what yardsticks should be applied to determine business size. For example, is independent ownership a critical factor? Is either sales volume or number of employees a logical guide in describing smallness? Can a small business be described accurately in the same manner in both manufacturing and retailing? Can a business properly be described as small because its competitors are much larger? These and many other questions

---

<sup>1</sup> In 1966, the Small Business Administration classified American Motors, the nation's 63rd largest company with more than 28,000 employees, as small business. This permitted American Motors to enjoy special advantages in bidding on government contracts. The decision illustrated the arbitrary nature of such definitions and the unusual classifications that are possible.

come to mind as an attempt is made to introduce some precision into the concept of small business.

The number of employees on the firm's payroll is perhaps the most widely-used criterion, with 100 employees constituting a typical line of demarcation between small and large business. As a practical matter, however, many quite different standards have been applied at one time or another. There has been little consistency even from one piece of legislation to another. In fact, guides adopted for one purpose have often seemed impractical for use elsewhere.

## Small Business Administration Standards

The Small Business Act of 1953 provides that a small business concern is "one which is independently owned and operated and not dominant in its field of operation." The Act also authorized the Small Business Administration, in making a more detailed definition, to use such criteria as number of employees and sales volume.<sup>2</sup>

In its lending programs the Small Business Administration has established upper limits for small firms as follows:<sup>3</sup>

Retailing and Service .....	\$1 million to \$5 million annual sales, depending on the industry
Wholesaling .....	\$5 million to \$15 million annual sales, depending on the industry
Manufacturing .....	250 or fewer employees (If employment is between 250 and 1,500, a size standard for the particular industry is used.)

## Committee for Economic Development Standards

An examination of quantitative standards provides some conception of the nature of small business. In fact, these standards are both useful and necessary for some purposes. It seems likely, however, that certain qualitative measurements may be more practical as the primary approach to an analysis of managerial problems peculiar to the small business. Perhaps the best outline of qualitative characteristics is that prepared by the Committee for Economic Development.<sup>4</sup> In the view of this organization, any small business is characterized by at least two of the following key features:

1. Management is independent. Usually the managers are also owners.
2. Capital is supplied and ownership is held by an individual or a small group.
3. The area of operations is mainly local. Workers and owners are in one home community. Markets need not be local.
4. 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 be definitely small in another.

<sup>2</sup> *Public Statement of Loan Policy* (Washington, D.C.: Small Business Administration, September, 1954), p. 1.

<sup>3</sup> *SBA Business Loans* (Washington, D.C.: Small Business Administration, 1973).

<sup>4</sup> *Meeting the Special Problems of Small Business* (New York: Committee for Economic Development, 1947), p. 14.

These characteristics vary in significance depending upon the particular problem involved. The factors of ownership and independence of management, for example, are much more important in financial management than in plant layout consideration. In general, the discussion of management concepts in this book is aimed at the type of concern that closely fits the C.E.D. pattern. More explicitly, the discussion will be directed toward independently controlled firms that offer both job and investment opportunities to entrepreneurs.

## SCOPE AND TREND OF SMALL BUSINESS

In determining the importance of small business in the United States, two questions must be answered. The first concerns the amount or proportion of small business, and the second relates to the trend in small business volume. Expressed otherwise, how much business is "small," and is small business growing or declining?

### Relative Importance of Small Business

An evaluation of the position of small business requires a comparison of small versus large concerns. A number of different measures might be used for this purpose. Based on the number of business units, for example, small business is of overwhelming importance. According to Table 1-1, about 95 percent of the firms have fewer than 20 employees, while fewer than 1 percent have more than 100 employees. This comparison is not completely realistic, however, because of the greater importance of large corporations.

**Table 1-1**  
**DISTRIBUTION OF FIRMS AND PAID EMPLOYMENT BY SIZE OF FIRM, 1967\***

Size Class (Number of Employees)	Percent of Firms in Operation	Percent of Paid Employment	Cumulative Percent of Paid Employment
All size classes	100.0	100.0	
1- 19	94.7	21.7	21.7
20- 99	4.5	18.2	39.9
100-499	0.7	13.2	53.1
500 or more	0.1	46.8	99.9**

\* Includes data for construction, manufacturing, mineral, retail trade, selected services, and wholesale trade industries.

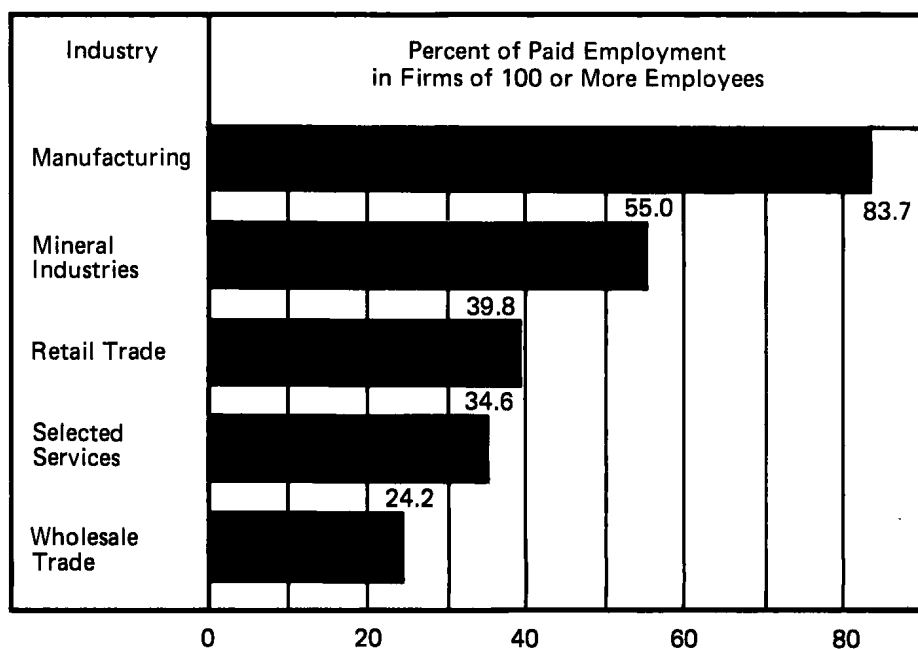
\*\* Total does not equal 100% because of rounding.

Source: U.S. Bureau of the Census, *Enterprise Statistics, 1967*, Part 1—General Report on Industrial Organization, Table 3-1 (Washington: U.S. Government Printing Office, 1972).

To correct this distortion, employment data can be used to show the distribution of personnel among businesses of various sizes. Even on this basis, small business accounts for a substantial portion of total employment. According to Table 1-1, firms with fewer than 100 employees account for about 40

percent of all paid employment;<sup>5</sup> those with fewer than 500 employees have about 53 percent. Regardless of the exact point at which one draws the line between large and small business, it is apparent that much—perhaps close to one half—of American business must be classed as small.

It is equally clear that small business is relatively more important in certain sectors of the economy than in others. Figure 1-1 presents a breakdown of paid employment by type of industry and size of firm. As might be expected, big business is strongest in manufacturing and mining. In contrast, small business predominates in service industries, wholesale trade, and retail trade. In the service industries, for example, only 35 percent of the employees in the industry are on the payroll of firms with 100 or more employees.



**Figure 1-1**  
**DISTRIBUTION OF PAID EMPLOYMENT BY INDUSTRY AND SIZE OF FIRM, 1967**

**Source:** U.S. Bureau of the Census, *Enterprise Statistics, 1967*, Part I—General Report on Industrial Organization, Table 3-1 (Washington: U.S. Government Printing Office, 1972).

## Vitality of Small Business

Political oratory might easily lead one to conclude that small business is vanishing and will soon be extinct. The champion of small business often

<sup>5</sup> Paid employment constitutes a simple and convenient criterion for an analysis of this type. One weakness is its tendency to understate small business volume by omitting proprietors, partners, and unpaid family help.



pictures small firms as powerless victims of big business corporations that are gradually taking over the economy. To understand the truth or error of these views, it is necessary to examine the trend of small business in recent decades.

Even though small business concerns have continued to survive, a question remains as to the business volume and importance of these units. Firms with a substantial volume may have been replaced by units of insignificant size. It is desirable, therefore, to examine changes in the structure of the economy with respect to the relative importance of different sized units.

Historical data for three industries (manufacturing, retail trade, and wholesale trade) indicate that the small business segment of the United States economy has grown less rapidly than the big business segment. Table 1-2 shows that, between 1947 and 1967, value added by the 200 largest manufacturing companies jumped from 30 percent to 42 percent of the total value added by manufacturing.

**Table 1-2**  
**PROPORTION OF MANUFACTURING ACTIVITY ACCOUNTED FOR BY THE LARGEST MANUFACTURING COMPANIES, 1947-1967**

Year	Percent of Total Value Added	
	By 50 Largest Companies	By 200 Largest Companies
1947	17	30
1954	23	37
1958	23	38
1963	25	41
1967	25	42

**Source:** *Statistical Abstract of the United States*, 1972, p. 703.

In retailing, Table 1-3 shows that chains with 101 or more units increased their percent of sales from 12 percent to almost 19 percent of the industry total between 1948 and 1967.

**Table 1-3**  
**DISTRIBUTION OF SALES IN RETAIL TRADE BY SIZE OF FIRM, 1948-1967**

Number of Units in Firm	Percent of Total Sales				
	1948	1954	1958	1963	1967
Single units	70.4	69.9	66.3	63.4	60.2
2 to 3 units	6.9	6.4	6.9	6.5	5.8
4 to 25 units	7.1	7.1	7.1	7.7	8.3
26 to 100 units	3.3	4.0	5.4	6.7	7.0
101 or more units	12.3	12.6	14.3	15.8	18.6

**Source:** U.S. Bureau of the Census, *Census of Business*, 1967, Vol. I, p. xxv; and *Census of Business*, 1963, Vol. I, p. 4-3.