# Market Justification for Policy on Small Enterprise Development

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ABSTRACT. The process of liberalization in developing economies and the increasing competition faced by Small Enterprises raise crucial policy issues on small enterprise development. The policy maker in developing economies like India are faced with the option of supporting small enterprises through steps like reserving certain industries or by developing their ability to compete in niche markets. Enterprise level decisions are also critical for survival of these organisations. Selecting from these options require an understanding of the advantages that small enterprises have over the large enterprises. The advantage of flexibility and responsiveness to consumer needs of small enterprise is expected to result in customer satisfaction in a market with differing consumer needs. The hypothesis relates customer satisfaction to market share in a heterogeneous market. A field study is carried out among consumers of packaged butter in a state in India. The results do not indicate customer satisfaction with lower market share in a heterogeneous market.

## 1. Introduction

Developing economies like India are opening upto global competition. The inability of some of the local firms to stand up to the challenges of the increasingly competitive environment is visible. In India, the "Bombay Club", a group of some of the captains of Indian Industry, has sought respite from global competition through the demand for a level-playing field (The Hindu, 1998). The small enterprises with limited resources would find the challenge of meeting competition to be extremely high. The policy maker can continue with existing policies of protection of these enterprises. The other option is to help small enterprises develop the ability to compete in niche markets.

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## 2. The policy dilemma

The policy options are reflected in the promotional and protective measures of the Government of India. The Government policies ensured the presence of this sector in a wide range of products. The policy measures of the Central and State Governments necessarily address the small enterprise requirements of credit, marketing, technology, entrepreneurship development, fiscal and infrastructural support. One other important policy measure for promoting this sector is the reservation of products for exclusive manufacture in the "Small Scale Industries" (SSI) sector. At present 812 items are reserved for manufacture in this sector. The important consideration for reservation of an item is its suitability and feasibility for being made in the small scale sector without compromising on quality aspects.

The Government is now considering a review of the reservation list. The economic reforms with its' emphasis on liberalization, de-licensing and deregulation has contributed to the thinking on de-reservation. A committee was constituted for the purpose of examining the reservation of products for small enterprises. It recommended to the Government for de-reservation of 91 items. A second "Expert committee to review policies for Small Scale Industries sector" recommended for total abolition of the reservation for small enterprises. The Advisory Committee on Reservation constituted under the Industrial (Development and Regulation) Act recommended to the government in 1997, that complete de-reservation at this stage is not desirable and de-reservation should be done in a phased manner (Small Industries Development Organization, 2001).

Those who argue in favour of preferences and

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quota for small enterprise presume that small enterprise is weak but has employment potential. Those who argue for removing preferences for small enterprise suggest that efficiency should be the criterion. They argue that, where small enterprises perform well they should be further strengthened. Literature identifying this view indicates that the support to small enterprise is limited to either financing or advisory services in a number of situations (Carlton and Hancock, 1998; Short, 2000; Strand, 2000). The need for state involvement in Small and Medium Enterprise (SME) development is suggested instead of the efforts to promote and establish business support services companies for small enterprise (Bateman, 2000). These divergent views suggest that it is not only useful but also necessary to examine the economic justification for existence of such enterprises in a competitive environment for policy decisions on small enterprise development.

## 3. Importance of the sector in India

The policy measures to support and protect small enterprise are due to the importance of the sector to the country. The production in this sector, exports from this sector and employment it provides are important considerations influencing the policy decision.

The small scale industries sector contributes 40% of the industrial production. It has been estimated that one hundred thousand Indian rupees ($2,222) in the small-scale sector produces 462,000 Indian rupees ($10,267) worth of goods or services with an approximate value addition of ten percentage points. The small scale industries sector grew rapidly with production increasing from 24.2 billion rupees ($538 million) in 1993–1994 to 53.8 billion rupees ($1,196 million) in 1998–1999. The number of small enterprises has increased from an estimated 874,000 units in the year 1980–1981 to an estimated 3,121,000 units in the year 1999. This contribution towards industrial production is high and it is a growing sector.

The contribution to exports by this sector is 35%. The number of small enterprises that undertake direct exports is more than 5,000. Export contribution is significant for this sector.

Small Scale Industries sector in India creates largest employment opportunities for the India populace, next only to Agriculture. One hundred thousand Indian rupees investment in fixed assets in the small-scale sector generates employment for four persons. Employment increased form 13.9 million in 1993–1994 to 17.1 million in 1998–1999 (Small Industries Development Organization, 2001).

## 4. Small enterprise performance and ability to compete

The importance of the sector to the economy and the policy maker dilemma raise issues of small enterprise capability to compete. The policy suggests reservations in those product-markets where small enterprises can provide quality products and services. This requires examining the characteristics and strategies of high performing small enterprises. The literature on small enterprises performance and strategies are examined. The suitable measure of performance is also examined.

Changes in the economic environment have brought about changes in Small Enterprise and the thinking on these enterprises. The small enterprises compensate for lack of scale through labour intensive production in the ’70s, being close to customers in the ’80s and flexible specialization in the ’90s (Meine, 1997). The common aspect of the strategies exhibited over the three decades is the ability to satisfy the specialized needs of a small group of customers that large enterprises do not find economically justifiable to serve. Small Enterprises exhibit profitability because of their ability to meet the specialized needs of customers. Flexibility and ability to customize their products and services fetch a higher price for these business (Hamermesh et al., 1978; Xavier, 1995; Velayudhan, 1996). Being close to consumer result in positive performance for small enterprises (McGee and Peterson, 2000). In addition to ability to serve consumer needs, small enterprise performance is affected by characteristics of entrepreneur and age of the firm (Jennings et al., 1997; Lin, 1998; Wijewardena, 1999; Roper, 1999). The presence of multiple influences including characteristics of entrepreneur, market position and operating environment is indicated (Roper, 1998; Roper, 1999). The limited studies that compare small firms performance with large firm performance also support the ability of former, to be "close to consumer" (Pelham, 2000; Stein, 1997; Coviello et al., 2000). Comparison with large firms also suggest technology and price competitiveness (Moen, 1999), flexibility and quality philosophy (Rodwell and Shadur, 1997), market orientation (Martin and Grbac, 1998) tailoring their offerings to meet the unique requirements of their clients (Hamermesh et al., 1978). The "close to the consumer", "flexibility", "quality philosophy" and "market orientation" indicate the focus on consumers' needs and orientation to meet these needs as one of the critical elements of small enterprise strategy.

A second set of literature that relates performance to size is that of market share and profitability. Small Enterprise generally hold a small share in any product-market, unless it is a niche player and the market is defined to be the segment served by the player. Literature suggests that profitability is directly related to market share (Buzzel et al., 1975; Buzzel and Gale, 1987). In a study modeling small business performance, the influence of firm's market position on small business performance is examined along with three groups of factors, characteristics of owner-manager, business objectives and operating environment. The firm size was found to have a positive effect on both turnover growth and profitability. The study also observed that high concentration of sales in a geographical market related to higher profitability; supporting the positive relationship between market share and profitability (Roper, 1999). Large market share is associated with lower costs that result from economies of scale and the experience effect. Exceptions to this relationship are due to non-homogeneous needs of markets, technological superiority, outsourcing and similar low cost approaches that are not due to either economies of scale or experience effect (Bloom and Kotler, 1975). Loss of flexibility to adapt to changes is a disadvantage of pursuing a market share oriented strategy (Abermathy and Wayne, 1974). The increasing "market share" decreases "customer satisfaction" (Anderson et al., 1994). The drawback of pursuing a strategy of obtaining a large market share is the starting point to search for suitable approach for the small enterprise. The availability of an approach for small enterprise to effectively compete with large enterprise suggests designing a policy to develop competitive capabilities over policy of reservations and concessions.

The literature survey on small enterprise strategy and performance, and also market share and performance, indicate that the performance variable is mostly "profit" or "growth". Small enterprise performance is usually a measure of growth (Wijewardena and Tibbits, 1999; Stein, 1997) or both, profit or return on assets and growth (McGee and Peterson, 2000; Pelham, 2000; Moen, 1999; Roper, 1999). It is observed that "Sales growth" and "profit/return on assets" are only weakly related. The direction of influence of some of the independent variables on the performance variables of "sales growth" and "profits" are opposite (Roper, 1999). Positive relationship between "Market Orientation" and "performance variables" of "sales growth" and "profit" is observed (Pelham, 2000). This is possibly because "market orientation" helps customer retention in the short-term and brings in "new customers" in the long-term through positive word-of-mouth information spread by the satisfied consumer. In addition to the relevance of consumer oriented measure of performance, the effective strategy for small enterprise is "customer focus". These therefore suggest that "customer feedback" would be an appropriate measure of performance for small enterprises (Coviello et al., 2000). "Customer Satisfaction" is an appropriate concept for reflecting performance. It is observed that "customer satisfaction" has direct effect on positive behavioural response of consumer (Athanassopoulous et al., 1999) and on purchase intention (Parasuraman et al., 1994; Cronin and Taylor, 1992; Cronin and Taylor, 1994).

The above review of literature on small enterprise strategy and performance, market share and performance, and on performance itself of small enterprises suggest the "market oriented" strategy of small firms succeed over the cost advantages of large share firms because of their flexibility to adapt to the needs of consumers. In the mass-market, it is the buyer who adjusts to the product offering. This suggests that customer satisfaction among buyers in the niche market could possibly be higher than customer satisfaction for buyers in the mass-market. This is true when preferences of consumers are heterogeneous and supply homogeneous (Fornell, 1992).

As market share increases, customer satisfaction reduces in a market with heterogeneous demand.

The implication of the hypothesis is that customer satisfaction is higher for the small enterprise. Such a relationship has relevance for policy decisions. It clearly indicates that small enterprise can find products and markets where it can effectively compete against large organizations. The nature of support to the small enterprises in such cases is in the form of capacity building. This requires developing management skills to support the entrepreneurial spirit. Non-acceptance of the hypothesis however, would suggest a need to establish mechanisms that provide protection to the small enterprise.

## 5. Methodology

"Customer satisfaction" is used to reflect performance. One approach to measure customer satisfaction is to use "self reports" of Presidents of firms to identify the focus of their firm on "customer satisfaction" (Meziou, 1991), the other is to use consumer perception. There is evidence to show that suppliers tend to make an over optimistic estimate of their relative quality compared to that made by their customers (Roper et al., 1997). The study therefore makes use of consumer perception of customer satisfaction.

The empirical analysis is based on data from a study of milk and milk products. The study was carried out for a local organization. The data was obtained through interview survey with buyers of packaged butter conducted between April and June 1996. The target population for the survey was households buying packaged butter in a southern state of India. This state was the market for butter for the local organization. The intention of this survey was to collect data from adult household members as they generally influence purchase decisions of such products. The sample for the study was developed in two stages. Locations that represented their markets were identified with the help of milk cooperatives. In these locations the door/house numbers were used to randomly select the households for interviews. The final sample consisted of 425 buyers of packaged butter, of which 182 purchased the national brand (A), 124 purchased only the local brand (B) and the rest had no distinct preference for either of these brands.

The sample profile is compared on education and income with the estimated profile for the state based on a very large survey by National Council of Applied Economic Research (NCAER). The comparison on education (Table I) shows that the graduates in the sample, is lower than the state profile. The income profile of the sample (Table II) is similar to the estimated distribution of income in the state.

The face-to-face interviews were carried out with the help of a structured questionnaire. The questionnaire was in the local language and was pre-tested through 20 interviews, to check for ambiguity and problems of response. The field investigators were undergraduate students who were briefed by the author and then provided practice through mock interviews. A field supervisor was present at the location to monitor the data collection.

The interviews were used to collect data on importance of product or service related factors

TABLE I
Comparison of education profile of sample with profile for the state

| Education | Sample (%) | State (large survey) (%) |
|---|---|---|
| Below undergraduate | 56 | 43 |
| Undergraduate and above | 44 | 57 |

*Source*: National Council of Applied Economic Research, 1998.

TABLE II
Comparison of income profile of sample for the state

| Annual income (Rs.) | Sample (%) | State (large survey) (%) |
|---|---|---|
| ≤ 25,000 | 39.22 | 37.27 |
| > 25,000 and ≤ 50,000 | 30.89 | 31.28 |
| > 50,000 and ≤ 77,000 | 19.19 | 18.66 |
| > 77,000 and ≤ 106,000 | 5.35 | 7.6 |
| > 106,000 | 5.35 | 5.17 |

*Source*: National Council of Applied Economic Research, 1998.

and to obtain consumer feedback on the brands of packaged butter they purchased. Customer Satisfaction and Service Quality Measures are generally used in studies on consumer feedback. Service-Quality scales are not used in this study as the relationship between Service Quality and Customer Satisfaction depends on the type of scale used and also the direction of relationship between Service Quality and Customer Satisfaction is not always clear (Parasuraman et al., 1988; Cronin and Taylor, 1992; Cronin and Taylor, 1994). Comparison of customer satisfaction measures to identify the optimum number of categories for a customer satisfaction scale suggest that 5 or 4 point scales work well in practice (Gleason et al., 1994). A four-point satisfaction scale was used. The draw back of this scale is lower discriminating ability and positive bias (Devlin et al., 1993). In a market with limited discrimination ability the rating scale of four was preferred and also positive bias was not a drawback here as the objective is comparison of satisfaction between brands. Even-number scale was used to avoid the tendency for neutral response (McDaniel et al., 1998) which may inhibit differentiation between brands.

The level of heterogeneity of the butter market is also examined. For this, a comparison is made between packaged butter market with a market having highly heterogeneous preference, the milk powder market. The importance of the different factors that affect choice is examined for those two markets using a four point scale.

## 6. Analysis and inference

The relationship hypothesized between market share and customer satisfaction is for a heterogeneous market. The heterogeneity of the market for pasteurized packaged butter is examined through comparison with a market that is very heterogeneous, the milk powder market. The market is considered heterogeneous if consumers vary in their preference i.e., when the factors considered important in the selection of brands vary among the consumers. The variance is therefore a suitable indicator of heterogeneity. Milk powder market is considered heterogeneous as it has a number of brands (more than a dozen) with reasonable shares that differ considerably in their offering and end-use. Some of these brands focus on milk for the small child, some others as additive to tea and coffee (dairy whiteners), other brands for multi purpose use (spray dried milk), and certain others are milk powders with nutritional additives. The standard deviation of the importance of each of the factors among the sample is worked out and from this the co-efficient of variation is obtained. The average co-efficient of variation is then compared for the milk powder market and for the market for packaged pasteurized butter.

Perceived importance of the factors "packaging", "more milk from a given quantity of powder", "white colour", "extent of sugar to be added", "made from cow's milk" and "price" are examined. The respondents indicate the importance of the above factors on the choice of a brand of milk powder. The mean importance, its standard deviation and co-efficient of variation are worked out for each of the above factors (Table III). The average co-efficient of variation for importance of different factors works out to 28.85%. In the case of pasteurized packaged butter, the factors on which importance is examined include packaging, taste, colour and type of milk used. As in the case of milk powder, the respondents are asked to indicate the importance of the above factors on the

TABLE III
Important factors in the milk powder market

| Factors | Mean importance | Standard deviation | Co-efficient of variation (%) |
|---|---|---|---|
| Packaging | 2.935 | 1.103 | 37.58 |
| Quantity of milk for a given quantity of powder | 2.917 | 1.037 | 35.58 |
| White colour | 3.357 | 0.671 | 19.99 |
| Quantity of sugar to be added | 2.86 | 1.141 | 39.90 |
| Type of milk | 3.50 | 0.781 | 22.31 |
| Price | 3.528 | 0.626 | 17.74 |

choice of a brand of butter. The mean importance, its standard deviation and co-efficient of variation are worked out for each of the above factors (Table IV). The average co-efficient of variation for importance of different factors in the purchase of packaged butter works out to 23.55%.

The mean coefficient of variation for "butter" is 82% of that of milk powder. This is interpreted as a 82% heterogeneity in "butter" market compared to the "milk powder market". In addition to the variance for each of the factors, there is variation between the "coefficient of variance" for the different factors. This again is higher for "milk powder" compared to that for "butter". In the case of "milk powder" the "coefficient of variation" is higher for some factors and less for the others. Therefore heterogeneity in the case of "milk powder" is higher than for "butter" but only on few factors. In the case of "butter" the variance is spread more uniformly over the different factors, increasing the likelihood of heterogeneous preferences among consumers. This, being the case the market for "pasteurized packaged butter" is considered to be heterogeneous for the purpose of this study.

The relationship between customer satisfaction and market share is obtained by comparing the customer satisfaction for a large market share national brand "A" with the customer satisfaction for a smaller market share regional brand "B". These are the only two suppliers of pasteurized packaged butter in the geographical market served by brand "B". The comparison of satisfaction level for the large market share brand "A" is performed with that of the smaller market share brand "B". The satisfaction level is examined on "packaging", "salty taste", and "yellow colour". For the factor "type of milk", consumers did not perceive any difference between brands and were not sure of the type of milk used. In the pre-testing of the questionnaire consumers did not perceive any difference between the brands on the factor "type of milk" and responses appeared to be forced. Customer satisfaction on the factor "type of milk" is therefore not included in the survey. The mean customer satisfaction on each of the three factors for both the brands is obtained and the difference between their means derived. A one-tailed test for the difference between means is performed for the three factors, at 0.05 level of significance (Table V). This test indicates that in respect of "packaging", the satisfaction levels of consumers are not significantly different between brands "A" and "B". Customer satisfaction levels are significantly different between brands "A" and "B" for the factors "salty taste" and "yellow colour". In all these three factors the satisfaction level for brand "A" is higher than for brand "B", i.e., the brand with higher market share has greater customer satisfaction than the brand with lower market share. The hypothesis is therefore not true.

TABLE IV
Important factors in the packaged butter market

| Factors | Mean importance | Standard deviation | Co-efficient of variation (%) |
|---|---|---|---|
| Packaging | 3.02 | 0.798 | 26.42 |
| Salt | 3.127 | 0.608 | 19.44 |
| Colour | 3.24 | 0.663 | 20.46 |
| Type of milk | 3.467 | 0.966 | 27.86 |

## 7. Discussion

The results obtained clearly favour policy guidelines that provide protection to small enterprise.

TABLE V
Influence of brand share on customer satisfaction

| Factors | Mean satisfaction | | Difference in satisfaction | Standard error of difference between two means | Upper limit of difference for acceptance as no difference at 0.05 level of significance |
|---|---|---|---|---|---|
| | Brand 'A' (large market share) | Brand 'B' (smaller market share) | | | |
| Packaging | 2.95 | 2.84 | 0.11 | 0.077 | 0.127 |
| Salty taste | 2.90 | 2.69 | 0.21 | 0.075 | 0.123 |
| Yellow colour | 2.98 | 2.76 | 0.22 | 0.081 | 0.133 |

Before drawing implications it is useful to examine the factors that could have negated the hypothesis. The possible explanation for the negation of the hypothesized relationship is based on aspects related to managerial initiative, methodology and conceptual development.

It is possible that the player having a small market share has an opportunity to serve specific consumer needs in a heterogeneous market. This is an opportunity that the small enterprise can exploit for providing better customer satisfaction, but the situation would not guarantee the customer satisfaction. Small enterprise would provide better customer satisfaction only if its marketing strategy exploits the opportunity of serving the specialized need of the consumer in a heterogeneous market. In the absence of such an effort, the offering of the Small enterprise would be perceived as an imitation of the dominant brand. A study that examines the direct and indirect effects of factors influencing small enterprise performance suggests that performance depends to a large extent on strategy choice (Roper, 1999). Understanding and providing consumer service influence small firm performance (McGee et al., 2000). The small enterprise therefore needs to deliver customized service for superior performance, suggesting the need to upgrade the ability of small enterprises to provide such a service. If this were to be true then it suggests that support to small enterprise is to be in the form of capacity building.

The second possible explanation for the hypothesized relationship between market share and customer satisfaction not being confirmed could be that the difference in market share between the brands is not sufficiently large. This reasoning is unlikely to be true as the result indicates a direct relationship between market share and customer satisfaction while an inverse relationship was hypothesized. This explanation can be valid only if the observed direction of relationship is the same as that of the hypothesized one but the relationship is not significant enough to confirm the hypothesis.

The third possible reasoning is that the observations of the PIMS study that larger player has better quality and commands a premium price, holds even in a heterogeneous market. When market share is high and therefore experience is high, the advantage is in terms of the opportunity to improve quality or reduce costs. There is definite evidence of such opportunities and their utilization by dominant players (Buzzel et al., 1975). This suggests that the policy maker needs to introduce measures to protect small enterprise if they are to survive.

The above explanations suggest that it is possible that the small enterprise has an opportunity to operate as a niche player and thereby generate high level of customer satisfaction. There is, however, a need for additional studies to confirm the presence of such an opportunity and the utilization of such opportunities by small enterprises. In the absence of any such confirmation till date, the results suggest inherent advantages for the large enterprise.

## 8. Implications for the small enterprise development

The findings negate the hypothesis that customer satisfaction is higher for the small enterprise in a heterogeneous market. The discussion on the results, suggest implications for research and policy.

One important implication of this study is that it indicates the need for additional research on the relationship between small enterprise strategies and market response. This is all the more so as small enterprise research is possibly one of the highly applied segments of development research which awaits further theoretical developments (Meine, 1997). The relevance of research on this for policy maker also suggests greater effort in the direction. It helps address the policy makers dilemma in choosing between protection to small enterprise and measures to develop competence among the small enterprises. A direct relationship between customer satisfaction and size of the firm would suggest protection to small enterprises i.e., measures like reserving certain industries exclusively for small enterprise or give price concessions and preference for small enterprise products in Government purchases. An inverse relationship between customer satisfaction and size of the firm suggests effort to develop competitive abilities of the small enterprise to serve niche markets. This could include setting up database on industry and market related studies to help the small enterprise identify unmet consumer needs. Other measures could include assistance to equip the small enterprises technologically, provide support to enhance purchasing power or develop skills to enable offering quality products and services that match the specialized needs of the consumer group it seeks to serve. The identification of the nature of relationship between customer satisfaction and the size of enterprise is an important input for policy making. Therefore, future research has to examine the relationship between market share and customer satisfaction in situations where the small enterprise serves specialized needs of the market. It is also relevant to compare the satisfaction level of customers of small enterprise in a homogeneous market and those in a heterogeneous market. Such a research design can strengthen inferences on explanations for the relationship between market share and customer satisfaction.

Another important area for research is the relationship between the extent of heterogeneity in the market and customer satisfaction with small enterprise. Conceptually in a heterogeneous market, the relationship between market share and customer satisfaction is inverse. It is necessary to identify the level of heterogeneity in the consumer needs and behaviour that create dissatisfaction with large enterprise. There is an indication of this in this study where the coefficient of variation of different factors differs. The influence on satisfaction differs according to the coefficient of variation. The coefficient of variation is high for packaging. This suggests a heterogeneous distribution on importance to packaging. This would suggest a lower customer satisfaction for the larger brand. The customer satisfaction is significantly higher for brand "A" on the other factors but not significantly higher for packaging, possibly because of the greater heterogeneity. The relationship between satisfaction and heterogeneity therefore needs to be examined for different levels of heterogeneity.

The study was carried out for only one product. The study has to be carried out for different products and types of products. The type of product is expected to influence the relationship between customer satisfaction and sales. In consumer non-durables consumer satisfaction influences repeat purchase and therefore influences the sales in the short-term and long-term. In the case of consumer durables where repeat purchase is not common the influence of customer satisfaction on short-term sales is less pronounced. The implications of these results at the enterprise level therefore vary by type of product.

The decision maker in the small enterprise has to ensure that opportunities for segmentation and target market selection be identified and exploited, as these hold the key to their ability to satisfy customers. The need for appropriate product-market decision is all the more critical for small enterprises compared to the large enterprise as the large enterprise can effectively serve the mass market as a result of scale economies and the opportunities created due to experience effect. The study could not confirm the advantages available for small enterprises. Discussion on the results, suggest that if advantage for small enterprises do exist in a heterogeneous market, it is by the meeting of specialized needs of consumers. This, therefore, requires careful identification and selection of product markets by the small enterprise.

The results of the study have implications for the policy maker. The policy decisions today exhibit an increasing trend towards removing protection for the small enterprise. The results suggest a need to rethink on this approach if small enterprise is to be promoted. The employment potential, reduced capital requirements and more equitable distribution of income and wealth suggest need to provide support that go beyond arranging finance and providing advisory services. Protection in the form of concessions or brand name/marketing support, purchase and price preferences and in extreme cases reservation of certain economic activity could be in order. This is required till research is able to conclusively establish the availability of product-markets where small enterprise can effectively compete.

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