SMEs' Preparedness to Face Economic Crisis: A Proposed Framework for Malaysian SMEs

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Abstract

Economic crises are becoming more frequent, due to which the economies are going in and out of recession continuously. Large organizations have the potential to survive recessions because of their huge financial base but problem becomes severe to SMEs'. SMEs' are the backbone of every economy; they are small in size but large in numbers. In Malaysia, SMEs contribute 32% of GDP and employ 59% of workforce. In this paper, authors have tried to establish a relationship between organizational crisis management preparedness with organizational performance, organization experience, CEO characteristics and risk attitude.It has been proposed that these factors have the potential to influence the organizations crisis management preparedness in SMEs' in Malaysia.

Key Words: Economic Crisis, SME, Globalization, Economy

1. Introduction

In today's globalized era, economic crises/recessions are occurring more frequently than ever before. The Economies of many countries have not recovered properly from the 2007-08 sub-prime crises and United Nations has indicated that the second round is coming and expected to hit the shores in the middle or late 2012. In addition, it is expected to be worse than the 2007-08 sub-prime crisis(United-Nations, 2012).Operating an organization in such a turbulent environment is becoming more and more difficult, when the economy of the country is constantly going in and out of recession. In such an environment, large organizations still have a chance to survive the economic crisis due to their huge resource base, but the problem becomes more serious or severe when Small and Medium Enterprises (SME) are considered, since they are small in size and they have limited recourses.

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SMEs are the backbone of every economy of the world; they are small in size but are very large in number. According to National - SME - Development - Corporation (2010-11) report, Malaysia SMEs make up 99.2 % of total business establishments in Malaysia. They contribute 32% in Gross Domestic Product (GDP). In addition SMEs employ 59% of total workforce.

Malaysian government has taken measures to make SMEs the backbone of the economy(Saleh & Ndubisi, 2006). One of the most significant actions that had been taken by the government to strengthen the Malaysian SMEs was the establishment of National SME Development Council in August 2004(Aris, 2007).

Even though Malaysian Government is taking measures to make SMEs stronger by providing information, training, financial support and enhancing the skills of owner-managers of SMEs through National SME Corporation, but still there are a number of questions that are needed to be addressed like: are the own-manager of SMEs are competent enough to fight the next financial/economic crisis, do they have the required skills to manage in turbulent environment and convert threats into opportunity? Owner-managers are more like craftsmen who are using their skills to earn a living (Cooper & Dunkelberg, 1986).

Gibb (2005)stressed that the competencies of the key players in SMEs will determine the success of an organization.Bolman Lee and Deal Terrence (1997); Burnett (2002); James and Wooten (2005); Wooten and James (2008) argue that competencies required in predicting and managing crisis are different from formal training on the job experience that leaders have, and competencies required for crisis management are a set of complex competencies.

Ahmad and Seet (2009) mentioned behavioral problems of owner-managers lead to business failures and their skills should be enhanced to overcome default rate. Markman (2007) states that strategic leaders possess knowledge, skills and abilities and these things help organizations to become successful. Ong, Ismail, and Yeap (2010) identified five problems being faced by Malaysian SMEs; among the problems, quality of the owner is one of them. Ahmad, Ramayah, Wilson, and Kummerow (2010)argue that owner-manager competencies of SMEs have direct effect on organizational success.

The above-mentioned researchers studied the characteristics/competencies of owner-managers, which are strategic in nature, focused towards running day-to-day business activities and tend to remain stable and focused towards the internal organizational and industry environment. Whereas these researchers did not address the required characteristics/ competencies for preparation/ managing the business when the broader set of negative economic environmental factors like economic/financial crisis or recession is about to effect or prevailing in the economy of the country. Therefore in order to address this problem, the current research will establish a relationship between organizational crisis preparedness of SMEs and factors that contribute to enhancing those competencies.

The current study is important to policy makers, owner-managers of SMEs and academicians. Policy makers can devise strategies that can make Malaysian SMEs' stronger, competitive, healthy and resistant to economic crisis. For own-managers this study will help them by presenting some factors that can help them to prepare for economic crisis and which organizational factors will help them to develop those skills. This will eventually strengthen them and their organization to become more resistant to the economic or other crises.

Theoretically, the current study will advance the literature regarding the crisis management and SMEs. As there is a dearth of literature on crisis management by SMEs, how SMEs prepare themselves for crisis, this gap in the literature is also supported byHerbane (2010). Herbane (2010) mentioned that "database searches of the title and abstracts of the International Small Business Journal (1982–present), Journal of Small Business and Enterprise Development (1994–present), Journal of Small Business Management (1962–present) and the Journal of Small Business Strategy (1990–present) found that not a single article published in these journals made reference to either 'crisis management' or 'business continuity management'/'disaster recovery' (the latter being practical manifestations of crisis management)", pp.44.

The current research advances the literature in terms of how preparedness by SMEs to face economic/ financial crisis are enhanced and which factors contribute towards preparedness. As for SMEs, literature will be advanced in terms of whether SMEs owner-managers need the crisis management preparedness techniques and if so, do the performance of an organization, owners' previous experience regarding financial/economic crisis, industry environment and attitude towards risk in decision making play any part in it.

In addition to that, the current research is using moderating variable (the risk attitude regarding decision making) to check the effect on relationships; this will also enhance knowledge regarding crisis management preparation. As previous researches were done on large organizations, researchers had only identified factors that contributed to crisis preparedness.

In order to analyze the research problem, the following objective has been formulated for the current study. To empirically analyze how prepared SMEs are to face financial crisis and secondly what factors contribute towards this preparedness. In order to fill the gap in the literature of SMEs and crisis management preparedness and to analyze the objective of the current study following research questions have been formulated. (1) Do SMEs have crisis management preparedness competencies? (2) Do organizational previous experience regarding economic crisis has any relationship with crisis management preparedness? (3) Is there a relationship between organizational performance and the crisis management preparedness (4) Do CEO characteristics contribute to the development of crisis management preparedness? And lastly, does the risk attitude contribute to the crisis management preparedness?

According to Pauchant and Mitroff (1992) crisis has five phases and these five phases can be divided into three essential types which are proactive, reactive and interactive. Proactive crisis management phase means if things are done properly then organizations can prevent many crises from occurring. Proactive crisis management consists of first two phases of crisis management and those are signal detection and preparation/ prevention phases. Following Pauchant and Mitroff's (1992) division of phases of crisis management, the current study will only focus on the proactive crisis management and try to answer the question; do own-managers of SMEs have competencies of these two phases and which organizational, environmental and personal factors contribute in the development of these competencies?

2. Literature Review

2.1 Strategic Management and Crisis Management

Ahmad, Ramayah, Wilson, and Kummerow (2010b) established the relationship between entrepreneurial competencies and business success (financial and non-financial) taking environment as a moderator. They took eight competencies to establish the relationship with business success.

In the current study authors are taking only one competency out of eight mentioned by Ahmad et al. (2010b) that is strategic management competency. As this competency is related to the crisis management, the relationship between crisis management and strategic management was established by Preble (1997). Preble (1997) argues that there are a number of similarities between strategic management and crisis management and they work in parallel to one another, one is offensive (strategic management) and other is defensive (crisis management) in nature.

A number of studies (Ahmad, Halim, & Zainal, 2010; Ong, Ismail, & Yeap, 2004) have been conducted in Malaysia where they have mentioned own-manager competencies as an important part. These studies have empirically and conceptually mentioned own-manager competencies in terms of strategic point of view.When entrepreneurs possess the knowledge, skills, and abilities to be a strategic leader their actions have the potential to make business successful (Markman, 2007). They formulate strategy by analyzing the environment, recognize threats and opportunities, and transform these opportunities into business activity(Beaver & Jennings, 2005). As business environment are changing and becoming increasingly complex day by day, it is becoming important for leaders to develop a set of skills that will help them prevent and effectively respond to crises and other strategic issues (Garcia, 2006; I. Mitroff, 2005).

When discussing threats or expected crisis to be faced by an organization, most executives are aware of the negative consequences associated with particular event, but their education, training and on the job learning experiences do not prepare them for crisis management (Wooten & James, 2008). Preparing for Crisis management leadership demands an integration of skills, abilities, and traits that allow a leader to plan for, respond to, and learn from crisis events. In the best possible case, crisis leadership is about handling a crisis in such a way that the firm is better off after a crisis than it was before (Brockner & James, 2008; Wooten & James, 2004).

2.2 Phases of Crisis Management

Five phases of crisis management have been identified by researchers (Coombs, 2004; I. I. Mitroff & Pearson, 1993; Pheng, Ho, & Ann, 1999) that represent a typical business crisis: (a) signal detection, (b) preparation and prevention, (c) damage containment, (d) recovery, and (e) learning.

The first phase, signal detection, requires leaders to sense early warning signals that announce the possibility of a crisis. In the second phase, prevention and preparation kicks in, leaders are expected to prevent the crises and prepare for it. The third phase involves limiting the damage by taking measures so that the crisis cannot expand to other parts of the organization or in its environment. During the recovery phase, leaders are responsible for implementing short- and long term plans designed to help resume business operations. Finally, in the fifth phase of crisis management, leadership encourages learning and examines the critical lessons from the crisis.

In the phases of signal detection and crisis prevention, the competencies focus on how organizations can eliminate vulnerabilities of a crisis and minimize their weaknesses based on warnings. The damage control phase of operation-oriented competencies helps to contain a crisis. Last, for business recovery and reflection/learning phases, the crisis leadership competencies focus on rebuilding the organization and knowledge creation. Since the scope of the current study is limited to signal detection and preparation phases of the crisis, therefore discussion is only limited to first two stages of the crisis management.

2.2.1 Signal Detection

In signal detection there are two main important components and these were identified by the Wooten and James (2008). These are sense making and perceptive thinking:

Sense making: "Sense making involves turning circumstances into a situation that is comprehended explicitly in words and that serves as a springboard into action"(Weick, Sutcliffe, & Obstfeld, 2005, p. 409). According to Weick et al. (2005), the process of sense making addresses three fundamental questions: How does something come to be an event? What does the event mean? What should I do relative to the event?

Perspective taking: Key element to social functioning is one's ability to entertain or assume the perspective of another person or group(Galinsky & Moskowitz, 2000). During a crisis, one of the main requirements from the leader is to ensure the well-being of those affected by the crisis. Perspective taking allows leader to better understand and empathize with stakeholders and act in the best interest of stakeholders.

2.2.2 Prevention/Preparation

In prevention/preparation there are three competencies and these competencies are issue selling, organizational agility, and creativity (Wooten & James, 2008).

Issue selling: Issue selling is the label used to characterize a set of behaviors used by managers to direct top management's attention to and understanding of important issues that otherwise would not be on their radar screen (Dutton & Ashford, 1993). In the current case since the owner is itself a manager of the organization, therefore the owner-manager has to highlight the issues to the employees and indicate to them how crisis has the potential to hurt organization and ultimately them.

Organizational agility: Crisis leaders who are competent in organizational agility have a thorough knowledge of all aspects of the business and can work across organizational functions, departments to accomplish a task(Wooten & James, 2008).Since they have knowledge of all aspect of their organization they can efficiently and effectively implement change management for the long term health of the organization.

Creativity: The concept of creativity in the workplace most often refers to the production of new or useful ideas, products, services, processes, or procedures (Amabile, 1996). In the context of the current study, competency in creativity is most relevant to how owner-manager works creatively and how he infuses creativity/innovation element into the organization. Owner-manager's ability to think creatively about how a firm is vulnerable to a crisis and plan accordingly requires thinking beyond the traditional approach of managing organization (Wooten & James, 2008).

2.3 Organizational Performance

To be successful in today business environment, comprehensive performance measurement reflecting the total situation of a business is important and needs to be established which then can be more fully aligned with business strategy (McAdam & Bailie, 2000). Hashim (2001) suggests financial profit and growth are the most common measures for organizational performance.

Nash (1993) identified the best indicator to know whether the company is on the right track is by the profitability it generates. Therefore profitability can be used as the primary measure of an organization success.

Light (2008) on the bases of empirical finding argues that organizations which are high performers are more crises prepared as compared to low performer organizations.

2.4 Environment and Risk Attitude

Entrepreneurs develop strategies to transform recognized opportunities into profitable outcomes (Carter & Jones-Evans, 2006). Entrepreneurs explore opportunities under uncertain conditions; therefore they are indulging in risk taking behavior (Muzychenko & Saee, 2004). Researchers (Cope & Watts, 2000; Harrison & Leitch, 2005; Stokes & Blackburn, 2002) have identified that, entrepreneurs do not act blindly when responding to risks, entrepreneurs learn from surrounding environment, previous mistakes made and from other people.

In SMEs the effect of the business environment on entrepreneurial activities affects the way businesses behave and are run by entrepreneur (Gnyawali & Fogel, 1994). In hostile environment owner-managers try to make connections with the network they are working in through their capabilities that enable them to choose the safest strategy that increases the organizations' performance (Baum, Calabrese, & Silverman, 2000; Covin & Slevin, 1989).

Whereas in benign environment Covin and Slevin (1989) argue that relationship between owner-manager's posture and organizations performance is somewhat weak. Van Wart and Kapucu (2011) argue that in crisis management the environment changes with moderate or at fast speed and accordingly the organization has to adjust otherwise organization can face serious consequences.

When talking about speed of decision-making and environment, risk comes into play. Ho (1996) argued risk is a factor of managerial choice. Managers' attitudes towards risk eliminate some strategic alternatives and prioritize others. Therefore, the decision makers do consider the risk associated with their decision when confronted with environmental uncertainty. Perceived risk is based on the tolerance of internationalization uncertainty by the decision maker (Wiedersheim-Paul et al., 1978) in the current case owner-manager.Two main principles of perceived risk have been recognized by (Eroglu, 1992; Mitchell, 1995)which are the probability of negative outcome and the consequences of the outcome. Risk mainly relates to financial and performance uncertainty and is more relevant to SMEs as they have less financial resources as compared to larger organizations.

2.5 Leadership Styles

Many researchers agree that leadership plays an important part in preparing organization for crisis(Light, 2008; Smith, Jennings, & Castro, 2005). Leadership role in crisis preparedness include the importance of management buy-in and commitment(Grigg, 2003; Light, 2008).According to Light (2008) most often mentioned leadership characteristics are Generating buy-in and commitment, getting adequate resources for crisis readiness, institutionalizing concerns of the community and other stakeholders, recruiting and motivating a high-caliber workforce, implementing sound day-to-day business management practices, taking a comprehensive approach to crisis readiness, and bridging gaps within the organization and between the organization's members and stakeholders, visioning a "business"- a new paradigm", developing trust within the organization, conducting vulnerability assessments, not letting risk aversion drive all decisions, actively engaging in learning, being aware of the special role of the leader.Grigg (2003) argues that leadership involves finding and recruiting the best possible workforce, and then keeping them motivated. Van Wart and Kapucu (2011) argue that crisis management is a special type of management and every phase of crisis management requires different type of leadership style. Light (2008) stated that shared vision plays a very important part in crisis preparedness and when leadership shares the organizations' vision, mission, perceived crisis with the employees, the organization become more prepared for crisis.

3. Conceptual Framework

In the current study as discussed earlier in the delimitation section only first two stages of crisis management are catered, these are (i) signal detection, (ii) preparation/prevention. The competencies required in these two stages of crisis management will be analyzed with organizational performance, owner-managers' previous experience regarding economic crisis, business environment and leadership style. In addition to that, the said relationships will be moderated by the attitude of risk taking in decision making process, how much perception of risk moderates the relationships. The conceptual model is presented in figure I.
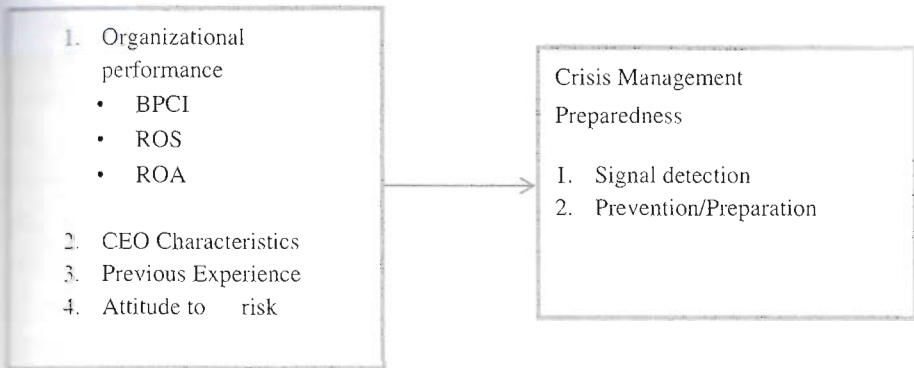
Figure 1: Conceptual Frame work

In order to answer the research question and to analyze the theoretical model, following hypotheses and have been developed:

H1: Previous experience regarding economic crisis has positive relationship with crisis management preparedness competencies of the organization

H2: Organizational performance has positive relationship with crisis management preparedness competencies of the organization

H4: CEO characteristics have positive relationship with crisis management preparedness competencies of the organization

H5: Attitude to risk taking has relationship with crisis management preparedness competencies of the organization.

4. Conclusion

There is an increase in SMEs thus also leading towards a strong need for strategic and tactical preparedness towards crisis management due to volatile, dynamic and hypercompetitive market conditions. The model purposed will assist SMEs in Malaysia to better understand their businesses preparedness to face a financial crisis.

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