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WHY IT'S GREAT TO BE SMALL

March 18-24, 2010

\$7.95 (inc GST)

www.brw.com.au

ISSN 07277458



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WHY IT'S GREAT TO BE SMALL

● Five years ago, Investor Choice Mortgages founder Jane Slack-Smith turned down established broking franchises Mortgage Choice and Aussie Home Loans to strike out on her own. While she was tempted by the support and small retainer that the franchises dangled in front of her, Slack-Smith didn't like the constraints that came with them.

"Although I could see the benefits of the structure," she says, "it didn't fit the absolute fundamentals of why I was doing what I was doing", which is providing independent proper advice to new and experienced investors.

Two years ago, Colin and DeAnn Thomson received an offer for their Queensland tortilla factory, only for it to be withdrawn when the foreign suitor (whose identity is masked by a confidentiality agreement but who is believed to be Mission Foods, part of Mexican food giant Gruma) was hit by the global financial crisis.

Colin Thomson now says it has been their best stroke of luck since founding the San Diego Tortilla Factory in 1995. While the suitor continues to wobble, San Diego posted a 31 per cent increase in sales for the 2008-09 financial year and is on track for 35 per cent increase in 2009-10. "Being smaller, we are a little more nimble," he says.

At first glance, Investor Choice Mortgages and San Diego are the exceptions that prove the rule: today's successful small business will become or be acquired by a big business tomorrow. Yet on closer inspection it might be the rule that no longer holds true: in the 21st century, could small businesses come to dominate industries controlled by big companies at the end of the 20th?

Alex Maritz, a former senior executive at some of the biggest of big businesses, including electronics giant Sony and drug-maker GlaxoSmithKline, certainly thinks so. "Entrepreneurs and small businesses are enjoying a renaissance the world over," says Maritz, now professor of entrepreneurship at Swinburne University's Australian Graduate School of Entrepreneurship. The reason: the economy of the future will favour businesses doing new things over those doing the same things but better. "The entrepreneur and small business owner is the bold and innovative deviator from established business patterns and behaviours of big business, and set to be the new force in the 21st century," Maritz says.

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The Davids of the business world are taking on the Goliaths and winning – and this trend will only increase as we head deeper into the 21st century. **Report: Anthony Sibillin**

MODEL THAT'S SPECIAL

A specialist does one thing very well while bigger rivals do several things, but not well. A specialist bets customers will be willing to pay more – for more; bigger rivals bet they will accept less – for less – especially if bundled with other products in one convenient and discounted package.

Absolute Data Group is a specialist Brisbane company that makes software which documents the construction of new war planes, frigates and helicopters. 10 staff regularly face off against the 5000 staff of its United States rival and market leader, PTC.

"We have beaten them to a couple of deals in the US," founder and chief executive Tammy Halter says, including, most recently, a contract to supply software and, which is building a new fleet of vessels for the United States Coast Guard.

"[Chand] said they chose us because of our attitude towards partnering and helping educate them about the technology and what they had to deliver in technical documentation to the US Coast Guard," Halter says.

Although PTC and other competitors' software typically have more features, Absolute Data stays closer to the technical writers that use it, meaning it can focus on including and improving the quality of features they want.

So when the defence industry recently brought in a new technical specification, Absolute Data rushed out new versions of their software to meet it. Initially "concerned" about being left behind, Halter polled her customers and discovered that few planned to adopt the new specification for some time.

"Instead, they [were] asking for particular features that make their life easier. We focused on that," she says.

Limited resources mean Halter is constantly juggling priorities – following industry specifications and meeting customers' most pressing needs. "Because we are very interactive with our customers, we listen for that fine balance and decide to weigh up which is going to be more of our priority, because we can only deliver one," she says.

Halter admits that, as a specialist, Absolute Data is vulnerable when rival players are prepared to discount heavily or throw in other services to win a contract. "We have actually seen PTC cut their software price in half to try and win a deal, and then they'll make up for it in consulting," she says.

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Top competition: Absolute Data Systems chief executive Tammy Halter

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That force is deviating into at least four promising business models. The first, and most familiar, involves scouring existing markets for segments or specialities which incumbents are ignoring or serving poorly (see 'The specialist model', above).

A second, emerging, model involves joining a physical or digital ecosystem, such as Apple's online marketplace for iPhone applications (see 'The iPhone apps model', page 23).

A third is to become a link in a national or international chain of originators, distributors and retailers (see "The link in the chain").

San Diego represents a final small business model of the future (see 'Profit wrap', page 24).

Instead of taking cover under a specialty ecosystem or supply chain, these Davids combine guile and nimbleness to win straight-up battles with the Goliaths of their industry. In their corner will be technology, consumers and government. Until recently, these all worked to make the "established business patterns and behaviours" of big businesses synonymous with the contours of a successful, modern economy.

Technology, in particular the meeting of electricity and assembly line, centralised production in factories; the bigger, the better. This gave consumers more and cheaper bread and soap. But it also unsettled them: in lieu of personal contact with the village baker and soap-maker, which big factory could they trust?

The ensuing competition among big factories to answer that question spawned newspaper advertisements, customer service lines and other trappings of the now familiar big brand.

Governments looked on the economy that big businesses were creating and were pleased with what they saw: big factories offered steady jobs;

big brands offered a form of consumer protection; and politicians could fit big company executives around a table and cut a deal.

However, as the 20th century drew to a close, big businesses were being undermined by their own success. Big agribusinesses and manufacturers could now satisfy the basic needs of Australians and other developed-country populations with a fraction of the capital and labour previously required. Capital and labour shifted to inventing new needs (marketing and media), managing wealth (finance and property) and defying death and decay (health and beauty).

SMALL BUSINESS THAT WILL WIN THE 21ST CENTURY

- Will stay in close contact with customers and "co-create" products and service in response to customers' changing requirements.
- Will not show "favouritism" and accommodate the smaller customers too.
- Will outsource and do everything else they can to offer complete solutions, whether the firm is capable of providing it in-house.
- Will be low volume but high-margin players: price wars are not their cup of tea.
- Will engage in "continuous business model innovation". Will reinvent themselves and bewilder bigger, slower rivals.

Source: Vijaya Thyll, Deakin University

Unlike the factory or industrial economy it replaces, this service economy defies corporatisation – witness the repeated, failed attempts to bring self-employed accountants and real estate agents under the roof of a single organisation, for instance.

As services move increasingly on to the internet, independent businesses can reach local, national and international markets, as well as add new features and try new business models, as easily as corporate rivals can. Ninety-five per cent of small businesses have fast internet access, the 2009 Sensis E-Business Report shows, with 78 per cent going online to place orders and 60 per cent to take orders.

Maritz says the economy is changing and so is the key task of business – from managing resources, which big businesses do best, to managing opportunities, which is where small businesses excel.

“We often see that corporates are efficient – doing things right – due to managing their resources, but they are not as effective at doing the right things,” he says. “It is the entrepreneurial small business which is most often more effective, due to being in the position to manage opportunities.”

Indeed, it is risk-shy managers, not a lack of ideas, who hold back innovation at big businesses, innovation expert and RMIT University researcher Mike Berry says. In a 2007 report, Berry notes that business is littered with the corpses of market leaders “blindsided” by the personal computer, no-frills airlines and other “disruptive technologies”.

Even when they’re not missed or ignored, innovations are unlikely to make it all the way up the decision-making chain, Berry says.

“In the first place, how does one establish a business case or plan for a product that has no clear market? Second, disruptive innovation has a high failure rate,” he says. “Chasing success through failure is not a recipe for individual corporate success.”

Companies try to “buy innovation” but research shows “most of the extra value [created through acquisitions of small companies] is appropriated in advance by the owners-shareholders of the acquired firm,” Berry says.

At the same time, big businesses and big brands have lost the monopoly on consumer attention they once enjoyed. “Businesses are faced with the customer message of, ‘Give me what I want, how I want it and when I want it’, while at the same time they want to be made to feel special,” says former retail executive Anthony Perrone, now a lecturer in commerce and marketing at Central Queensland University.

In today’s competitive marketplace, there are far too many options for consumers to buy elsewhere if this does not take place. Small local and owner-operated businesses are strategically placed and are able to forge relationships with

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THE iPHONE APPS MODEL

The smartest big businesses know small businesses do some things better than they do – like spotting consumer trends and developing new products to exploit them.

Apple learnt this the hard way. Its old business model of making everything – from computer, to operating system, to applications – worked for a time before almost sending it bankrupt in the late 1990s. Its new business model for the iPhone leaves the job of creating applications for the smartphone to thousands of independent small businesses such as Melbourne developer Pocket Pixels.

Pocket Pixels founder Rick Bavage says the iPhone App Store has introduced more than 40 million potential buyers to his three health-related applications. He charges US99¢ (\$1.08) for “Cholesterol Coach” and \$US1.99 for “Sick of Smoking” (and gives away a Chinese edition of the latter).

Naturally, access to a ready-made 40 million-customer base comes at a price: Apple swipes 30 per cent of the value of each sale. And Apple can refuse to list applications it thinks will harm its own business interests.

Still, the App Store is preferable to the obscurity to which small developers might otherwise be condemned. Bavage is also glad not to have to rely on advertising. Besides, developers can always choose another online application marketplace. Rivals have noticed that a big reason Apple will sell 36 million iPhones in 2010 and 48.5 million in 2011, according to investment bank Piper Jaffray, is the more than 150,000 applications in the App Store.

Android Market (for Google-powered smartphones), BlackBerry App World and the Windows Marketplace for Mobile all now compete for developers’ smartphone applications. In mid-February, the world’s biggest mobile operators, including AT&T, China Mobile and Singtel, announced they would also launch their own device-agnostic marketplace. Marketplaces for makers of physical products include eBay and GraysOnline.com.au.

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their customers more efficiently and effectively than much larger operations," he says.

Small businesses also appeal to the growing number of environmentally minded consumers, says Adam Turner, head of research and analysis at Trendwatching.com. "They offer a human face with which to do business, providing a tangible link between products and services and the sustainability of their delivery," he says.

Even big businesses recognise consumers are turning away from them. Witness the attempt of Westpac Banking Corporation, the country's second-biggest bank, to present managers as part of the local community, by scrawling "I am dad", "I barrack for Collingwood" and other biographical information on branch windows. The big opportunity," Westpac marketing general manager Andrew Seager says, "and part of our strategy, is to put back into local communities. How, for example, can bank managers understand local conditions and make local decisions?"

Small business owners don't need a "strategy" to answer this question. Unable to buy their way



Even when they're ... ignored, innovations are unlikely to make it all the way up the decision-making chain

Mike Berry, RMIT University

on to prime-time television, their livelihoods depend on staying in close contact with customers and the communities they service (see 'Small Businesses that will win the 21st century', page 22).

Governments, too, have begun to distance themselves from the big businesses they once embraced. Politicians have recognised that small businesses tend to be more entrepreneurial than large ones, putting them in the vanguard of this century's innovation-led economy. In Australia, governments have set up websites to encourage

business creation, and funded grants and loans to get these businesses off the ground.

Unfortunately, governments are also among the barriers to a local small business "renaissance", says Australian Chamber of Commerce and Industry economics director Greg Evans.

"High levels of regulation, particularly imposed by state and local government, continue to figure as a major constraint on investment by [small and medium enterprises] and the situation has worsened over the past decade," Evans says.

"Over-regulation and regulatory creep affects all business irrespective of size and ultimately imposes costs which flow through to the whole community. Small business, however, is often hit hardest as it has less capacity to absorb those costs and to understand, monitor and comply with changing regulations," he says.

Evans suggests a "one in, one out" policy, where new regulation can be introduced only if some existing regulation is removed. He also favours ensuring more rigorous cost-benefit analysis is done to test whether a legislative



Ready to jump: San Diego Tortilla Factory founders Colin and DeAnn Thomson

PROFIT WRAP

Big is not always better, even in industries where the more you produce, the cheaper it gets.

Consider the San Diego Tortilla Factory. Co-founder and director Colin Thomson readily admits the new Melbourne factory of its big rival Mission Foods, part of Mexican food giant Gruma, can make tortillas and wraps for less than his 15 year-old Queensland plant can.

"However," Thomson notes, "when a big manufacturer chooses to spend something like \$100 million on a factory, that is a lot of tortillas they have to sell."

And if they don't sell enough, the average cost of making each tortilla at a big factory operating well below capacity can easily exceed that of a small factory at full tilt.

While San Diego can at best match Mission Foods' unit-production costs, it is in front of its bigger rival when it comes to responding to fast-changing consumer tastes.

"We are allowed to change tack fairly quickly," Thomson says, "whereas the big guys have got the sausage machine going, and there is a lot of planning involved in making any strategic changes. My wife [and co-founder, DeAnn] and I will have a discussion and say, 'Crap, here is an opportunity, let's see what we can do about it'. We've turned inquiries around for specific products in under a week in some cases. We can get a sample out to a customer, in front of them, they can taste it, and pretty much get a decision made fairly quickly on alternatives," he says.

Coles and Woolworths have rewarded this responsiveness with a place on their prized supermarket shelves. Fast-food chains also rely on San Diego to keep up with fickle customers. For instance, burger chain Burger Fuel recently approached Thomson for a low-fat, low-carbohydrate wrap, in tomato, saffron and spinach flavours, for its "low carbo-rators" range.

"We were able to turn that around fairly quickly for them," Thomson says. "The volumes are not substantial. I don't know of any major manufacturer who would want to entertain that."

For its part, San Diego has not had annual sales growth of less than 25 per cent in its 15 years in business. In 2008-09, sales grew by 31 per cent to \$4.5 million. "[We] are looking at 35 per cent for this [financial] year," Thomson says.

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response is really needed, plus annual government statement of the direct and indirect cost of all regulation it has introduced.

Berry agrees governments should keep out of small companies' way while getting basics such as education, internet access and transport right.

Less visible, but also impeding small businesses, is undue deference to bigger rivals. This is particularly apparent in the banking industry, says Ken Roberts, managing partner of Melbourne company Forethought Research, which advises banks and superannuation funds on their marketing strategies.

Roberts says one in five Commonwealth Bank of Australia customers, and one in six customers of the other three big banks, is "seriously considering moving" to another institution. However, despite trouncing the big four banks in customer satisfaction, Australia's 118 mutual credit unions and building societies are not picking up these dissatisfied customers.

While each mutual has a relatively weak brand on its own, together they have a very powerful one, Roberts says. "The credit unions' failure to come together and take advantage of their umbrella brand is what has held the sector back in Australia."

The exemplar? Industry superannuation funds, which have weak individual brands but exploit a powerful collective one. Industry funds "operate collectively in terms of their communication, but highly independently in terms of their businesses", Roberts says.

Even in an industry such as banking, where consumers tend to correlate size with trustworthiness, small organisations can thrive if they excel at "treating the individual as a valued customer", he says. "The whole issue of trusted organisation is a primary driver in the reputation element of the brand. However, consumers will trade this off, to a degree, for prompt and personal service."

For his part, San Diego's Thomson is not looking back to the multimillion-dollar exit snatched away from him two years ago. "The flat-bread industry has blossomed," he says. "It's not just tortillas. It's Lebanese bread. They've all had a bit of a renaissance."

Thomson warns it is in the interests of big businesses, as well as governments, for that renaissance to extend to other small manufacturers and businesses.

"They need to support the small manufacturer," he says. "Because if that smaller manufacturer disappears, they will not have any competitive advantage. The prices will suddenly be quite different and there will be no competitive negotiation. If you like, we are trying to keep the major players honest."

"But we can only keep them honest if you've got the major retailers willing to maintain some competition in the marketplace.

"They will suffer down the line if they don't do that." **BRW**



LINK IN THE CHAIN MODEL

Big businesses' success in the 20th century was based on mass production and mass distribution under the roof of a single organisation. "An 'integrated' industrial firm could find economies of scale in everything from purchasing to advertising," write John Micklethwait & Adrian Wooldridge in *The Company: A Short History of Revolutionary Idea* (Phoenix, 2003).

"The key was to own as much of the process as possible." At one point, United States car maker Ford even owned the land on which the sheep grazed that produced the wool that went into its seat covers.

Then, in the final quarter of the 20th century, the world started moving in the opposite direction. Modern technology and globalisation have made it feasible for big businesses to hire others to perform certain tasks they once did themselves. This unbundling of big businesses, a process the internet is accelerating in the 21st century, is creating a huge range of opportunities for small businesses to become "links" in national and global supply chains.

New South Wales company Investors Choice Mortgages is one of them. Founder and director Jane Slack-Smith has brokered more than \$75 million worth of property loans over the past five years. Slack-Smith is the beneficiary of the unbundling of financial institutions, which used to write all their own loans. The *Genworth Financial Mortgage Trends Report* reveals that last year 41 per cent of borrowers said they used a mortgage broker for their most recent loan, up from 30 per cent in 2005.

Five years ago, Slack-Smith chose broking because the commissions would let her run property seminars before she was established enough to charge for them. She considered buying into one of the established broking franchises such as Mortgage Choice.

Although tempted by the support and small "retainer" the franchises dangled in front of her, Slack-Smith didn't like the constraints they came with. "Although I could see the benefits of the structure," she says, "it didn't fit the absolute fundamentals of why I was doing what I was doing – which was either sitting down with really experienced investors ... and finding a solution for them or, more importantly, with those just starting and saying, 'This is possible, and it is going to be scary, but let's do it one step at a time!'"

Slack-Smith works from home but regularly delivers two-day seminars – for which she is now able to charge \$1500 – around the country. She employs two staff to handle the paperwork but relies on one of 10 large mortgage aggregators to deal with lenders on her behalf.

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Fewer constraints:
Investors Choice
Mortgages' founder and
director Jane Slack-Smith