Entrepreneurship and the Profit Zone Concept:
Why Profit Models Theory doesn’t Fit in the Small Firm’s World

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Abstract
Small businesses have now become the economic motor growth of numerous countries and regions, as it is the case for the United State and the majority of Canadian provinces. SME scientific literature is now a Business Management discipline of and this field of research agrees on one thing; strategic planning and managing of that type of businesses would be different from the one used by larger sized firms. Yet, new business models identified today and more specifically the profit zone model were often developed from studies conducted on large-scale American enterprises. The aim of this article is to demonstrate some convergences and divergences about the profit zone model applied to the SME context. In fact, we will find out (1) that if profit zone models are present in SME, these same profit models are not part of the cognitive territory of small business presidents and managers, (2) there exist, depending on the industry, significant divergences with regard to profit models selected, (3) that SME managers are able to positioned themselves among the 22 different profit models identified by Slywotzky & Morrison (1997) and (4) that if, from a strategic standpoint, large enterprises must generally focus on one or two profit model, the picture is totally different with SME.

Résumé
Les PME sont devenues le moteur économique de plusieurs pays ou régions comme c'est le cas pour les États-Unis et la majorité des provinces canadiennes. La littérature scientifique portant sur la PME est maintenant une discipline des sciences de gestion en soit. Elle s'entend pour dire que la planification et la gestion de ce type d’entreprise seraient différentes de la grande entreprise. Pourtant, les nouveaux modèles d’affaires identifiés aujourd’hui et plus spécifiquement le modèle de la zone de profit ont souvent été développés à partir d’enquêtes menées sur la grande entreprise américaine. Cet article vise à démontrer les convergences et les divergences de la théorie de la zone de profit lorsqu’elle est appliquée au contexte PME. En effet, nous constaterons (1) que si les modèles de profit sont présents dans les PME, la notion même des modèles de profit ne fait pas partie du cognitif du dirigeant de la PME (2) qu’il existe des divergences sectorielles significatives quant aux choix des modèles de profit retenus (3) que les dirigeants de PME arrivent à se positionner parmi les 22 modèles de profit identifiés par Slywotzky & Morrison (1997) (4) que stratégiquement, si la grande entreprise doit focuser généralement que sur un ou deux modèles de profit, il en est tout autrement pour la PME.
Introduction

More than ever before, Small Manufacturing Enterprises play a fundamental role in the United State and the Canadian economy. In fact, in these two countries, SME are responsible for the creation of more than fifty percent of the private sector labour force which, as a result, amount to half of the GNP. Together, they contribute to 80% of all exportations. Annually, SME can account to 60% to 80% of all new jobs created. Moreover, small businesses can produce 10 times more patents per employee than large enterprises and employ close to 30% of high technology skilled labour (Statistic Canada, 2003; U.S., Small Business Administration, 2003.)

As a result of this new economic force, many academic and practical articles have related the wide range of specific studies on SME searching to understand its ability to plan strategically, to manage its growth, to implement its processes and more recently to manage innovation and change. On one hand, these studies have highlighted a first scientific stream where a consensus was arrived at the necessity to distinguish between SME and the large enterprise, that there exist significant differences between the two types of enterprises and that these differences are principally due to the relative size of each organizations (Cavysgil, 1980, Yaprak, 1985.) Besides, Scarborough and Zimmerer (1987) have even debated that SME should not refer to the same managerial tools and techniques used by large enterprises. They even claim that the use of these tools and techniques could possibly explain why so many SME eventually go bankrupt. As a matter of fact, literature related to SME on this issue as often bring to light the relationship between action modes and the manager’s character who, within his SME, often take intuitive and opportunistic decisions based on perceptions. This would explain why business plans are often less formalized that those found in large enterprises (Thomas, 1989; Shrader & al., 1989) and that the use of a very informal planning process does not seems to influence SME performance (Robinson & Pearce II, 1993, 1998; Ackelsberg & Arlow, 1985.) On the other hand, more recent research and studies have demonstrated that SME do plan more than we were led to believe and do make use of many planning tools and techniques (Ibrahim, 2004; Rue & Ibrahim, 1996). In fact, Moyer (1982) has reported that all enterprises, regardless of their size, must be capable to execute necessary strategic planning functions. Thus, even though past scientific literature seemed to explain that SME managers would look at planning with scepticism, many statistical reports confirm today that innovative SME are aware of the importance of strategic planning and of the necessity to make use of innovatory activities (Baldwin, Diverty et Sabourin, 1995; Baldwin, 1998; Baldwin et Johnson, 1998; 1999).

In fact, the new economy, the technological progress and business design innovations have urged more and more enterprises, large and small, to redefine their managerial modes in order to reach a higher performance. With a multitude of environmental changes, this new economic order as forced an enterprise to change. This change ended up in a shift from a volume and market share growth to a value growth, a transformation of the business design towards profit zones (Slywotzky & al. 1999). Therefore, because of rapid and discontinuous changes in today’s world performance can no longer be reached sole on the basis of the traditional strategic planning process (Hammel, 2000). Thus, literature in the area of managerial sciences recognized, more than never before, the need for an enterprise to redefine and redesign new business model (Hammel, 2000;
Slywotzky, 2000; Almasy & Slywotzky, 1999; Slywotzky et al. 1999) in order to reach and maintain a sustained competitive advantage and an above average profit zone. The new business models of the enterprise, large and small, must be seen as a fundamental element essential for an organization to reach its finality. To be durable, a good business design must be regularly reinvented taking into account customer evolution and value migration. If not, such as an obsolete technology, it will lose its effectiveness and will not generate value. The profit zone will then be displaced. To plan strategically today means to identify tomorrow’s profit zone (Almasy et Slywotzky, 1999).

It’s probably Slywotzky & Morrison (1997) in their best seller that gives the best interpretation of the concept. For these authors, a profit model describes the fundamental essence of how businesses manage to achieve profit and add value in today’s competitive market. Based on the study of large enterprises, the authors identified 22 profit models. Each one of them holds unique characteristics that contribute to best competitive advantage and therefore, to a better performance of the firm. Each is simple to describe and highly focused in its orientation.

**Purposes of the study**

Small businesses have now become the economic motor growth of numerous countries and regions, as it is the case for the United State and the majority of Canadian provinces. SME scientific literature teaches us that planning and managing this type of enterprises would be different from the one found in large enterprises. Yet, new business models identified today and more specifically the profit zone model were often developed from studies conducted on large-scale American enterprises. The aim of this article is to demonstrate some convergences and divergences about the profit zone model applied to the SME context. In fact, we will note (1) that if profit zone models are present in SME, these same profit models are not part of the cognitive territory of small business presidents and managers, (2) there exist, depending on the industry, significant divergences with regard to profit models selected, (3) that SME managers are able to positioned themselves among the 22 different profit models identified by Slywotzky & Morrison (1997) and (4) that if, from a strategic standpoint, large enterprises must generally focus on one or two profit model, the picture is totally different with SME.

**Sample and methodology**

This article takes its source from a recent study, which explored best practices used in managing innovation and operations for technological manufacturing SME. The Canadian Research Chair in Enterprise Engineering, CENTOR Research Centre, Laval University conducted this study. The SME sample of 20 businesses was chosen from 4 industrial sectors located in the Greater Quebec City region in Canada: electronics, optic-photonic, biotechnology and plastic-composite. The principal selection criterion was to have a significant high-tech manufacturing management.

The research methodology used was a semi-structured interview that offers a deeper understanding and also let the emergence of natural answers from our interviewers. The survey contained 17 sections and took our SME presidents and managers 3 hours to answer. From the global questionnaire, this article focuses on one question relative to identification of how well the respondent felt that a specific
profit model would fit with his high-tech manufacturing SME. We explained to each participant the 22 profit models described by Slywotzky & Morrison. For each model, the participant had to indicate on a scale of 0 to 1 the degree they believe would best represent his enterprise.

Results of the study

a) What profit models mean to SME managers

The first element to point out is that none of the managers had any familiarity with the notion of profit model and that each participant was initiated for the first time with each model when they were asked to fill the questionnaire. Therefore, each participating manager had very little time to think attentively and absorb deeply the signification and the implication of each model. Figure 1 shows the average representation degree for each of the 22 models for all enterprises, selected from the most representative one.

Figure 1
Degree of representation of profit models for the entire sample

![Diagram showing the degree of representation of different profit models for the entire sample. The highest percentage is for Customer Solutions Profit at 63%. Other models such as Specialty Product Profit at 55%, New Product Profit at 53%, Specialization Profit at 45%, and Bran Profit at 41% are also shown.]
Recent literature related to the new economy states that managers must be able to well define the profit business model, which has an impact on a multitude of managerial, technological, and marketing decisions. It was clearly evident while we were conducting this study that the notion of profit model, as defined in recent years’ scientific literature, is not part of the cognitive world of the SME manager surveyed. It became necessary to explain to them the concept to ensure that they could answer the question.

However, once the necessary explanation was given, the managers surveyed were capable to position themselves clearly on many profit models. The most preferred model such as customer solutions profit, specialized products, new product profit, specialization profit, bran profit, time profit (advance innovation), experience curve profit and low cost business design profit are, by their nature, consistent with general recognized SME manufacturing technology characteristics. Emphasis is made on solving design, which are customer, innovation, originality and velocity oriented. Niche specialization and experience are sought and this is consistent with logic management attached to SME. Lastly, faced with financial constraints, the business design seeking an operation at the lowest cost is naturally considered.

b) Sector divergences relatively to the chosen profit models

In line with our review of literature, emerging profit models from our survey are very different from an industrial sector to another as shown in Figure 2.

Enterprises from the optic-photonic sector generate their major profits from a wise selection of R & D projects in search of new specialized new products. They continuously try to maintain a technological advantage. They endeavour to be close to their customers in order to create appropriate solutions, which are often personalized. There exist also a major issue of worldwide recognition.

In using their specialized talents, plastic-composite enterprises mainly managed their profits by innovating and developing customer-oriented or client solutions. Here again, major issues are associated with industry recognition.

In the biotechnology sector, much emphasis is made on the introduction of new product profit where high margin profits are expected. However, as a result of heavy investments required to market a biotech product, these enterprises look for blockbuster profit model strategy. They also manage to minimize their risk by decomposing themselves into smaller semi-autonomous units favouring the entrepreneurial profit model.

Somewhat like the plastic-composite sector, the mature electronic sector seems to favour the customer solutions profit model as well as the specialty product profit model.
Figure 2
Mean degree of profit models representation by sector
c) SME selection of the 22 profit models of Slywotzky & Morrison (1997)

Figure 3 demonstrates that no enterprise believes to be represented by one profit model. In fact, enterprises recognized themselves using an ensemble of profit models, which would vary between 4 and 21 models (on a total of 22 models), with an average of 10.95 models. Each enterprise can count between 2 and 16 highly representative profit models (representation degree ≥ 50 %) of their activities. The observed mean is 7.15 of the models judged highly representative. The sum of all representation degrees allowed to all significant profit models varies between 180% and 1200%. Enterprises get an average total of 592.25%, each profit model with a representation degree set between 0 and 100%. Among representative profit models of an enterprise, an average of 67% of these models are judged highly representative (representation degree ≥ 50 %). In our sample of enterprises, this ratio varies between 25 and 100%.

Figure 3
Sum of representation degree and the total number of global models and superior or equal models to 50% for each enterprise
Contrary to theory notions surrounding profit models, enterprises do not fit one and only profit model. The average enterprise is rather represented by a mixture of profit models (on the average 11 models) where 67% are highly representative (representation degree ≥ 50 %) and 33% are weakly representative (representation degree < 50 %). If we total up all the representation degree allowed to all the profit models judged representative for one enterprise, we get an average value of 592%. This value is comparable to a new value obtained from 6 perfect representative profit models (representation degree = 100%) or the result of 12 average representative models (representation = 50%).

d) Number of profit models representative of the SME world

If each participant had judged only one single profit model among the 22 models from Slywotzky and Morrison as representative of his enterprise, he would have given a score of 1 to that model and 0 for the other 21 models. If this were the case, the average percentage of one model for the entire group would have been 4.55% (1/22). However, the results show clearly that all profit models except one have a percentage higher that 4.55%. For example, the profit model that was the most selected, customer solutions profit rose at an average of 63%. Therefore, instead of a total weighting of 4.55%*20=91%, because all interviewers did not identified themselves to just one model, the total percentage result is 594%; that is 6.5 times more than one model. This means, generally, that each manager considered that 6.5 profit models represented well their enterprise.

The average SME is somewhat represented by an amalgam of different profit models (in fact an average of 11 models). In fact, each enterprise sees itself as a complex composite that needs to build its profit model on more than one of the basic profit models.

Figures 4 and 5 expose those profit models with a representative degree in a sector that exceeds respectively of 50% and 33%. This last value corresponds to the average degree of representatively base on the entire 22 models. The link between selected profit models and the industrial sector involved are exposed in each Figure. Models belonging to one and only sector are represented by a circle. Models observed by two sectors are identified and connected by a line. Models mentioned or observed by three sectors are represented by a triangle and are linked together. Finally, all observed models by four sectors are represented by the lozenge in the centre of Figure 5.
Figure 4

Diagram of industrial sectors with their respective profit models
Where the representation degree is superior to 50%
Globally, the most representative models of all high-tech manufacturing SME were the new product and specialty product profit models. In addition to that, customer solutions profit and famous trademark as Brand profit models were chosen based on the experience curve and specialist strength. Studied SME also chose the innovative advance in time profit model implicitly meaning to always be ahead their direct competitors. The relative market share profit and the value chain position were two other models that were very representative when firms were looking for lower cost and optimizing profit. All the models, customer solutions, specialty product profit, new product, specialization profit, brand profit, time profit, experience curve and low cost business design are by their nature consistent with the characteristics usually well known to the high-tech manufacturing SME. In line with the literature, that type of enterprise strategically orients their solution designs through their clients, using innovation, originality and velocity. High-tech manufacturing SME also focuses on niche specialization and experience. Finally and logically, if an enterprise is stuck with financial constraint, entrepreneurs naturally choose an organizational design that focus on low cost operation.
To Conclude

This article enlightens some convergences and divergences between empirical field evidence from actual SME and the profit model theory. Clearly, the purpose of this article was not to invalidate the notion of the profit model and this study is exploratory. Nevertheless, it generates some deep interrogations and lead us to believe that further and larger samples will be required in further studies related to the concept of SME profit models.

The notion of profit model, highlighted in the managerial sciences literature of recent years, does not cover the cognitive world or territory of the managers of SME surveyed. The question remains whether the results are due to lack of understanding by the respondents, or are rather an accurate statement that of the intricacies involved in developing a winning profit model for a high-tech manufacturing SME? If the latter is true, then is the divergence a distinction between high-tech manufacturing SME and large size enterprises from which the theory has been developed? Or would such a divergence rise even in investigating large enterprises? Is this because of a poor comprehension or understanding from SME managers of the profit model concept or is it a lack of knowledge of the managers interviewed in our research? Is this to confirm the intuitive management attributed to SME managers or is it because the latter lack the necessary time to undertake an in dept strategic thinking or reflection?

However, we arrive at the same conclusions elaborated by Slywotsky & Morrison (1997). There exist some definite divergences of profit models from one industry to another. On the other hand, the authors explain that strategically speaking, large enterprises must focus on only one of the 22 profit models. Our study shows the adoption of more hybrid and complex models for our SME. Contrary to theory notions related to the profit models, no SME surveyed believe to be represented by only one profit model. Moreover, we realize that a majority of manager implicitly selected a highly hybrid combination of 6.5 models among the 22 proposed models. Is this a phenomenon simply linked to a lack of maturity of the SME surveyed or again a lack of corporate identity, which would prevent managers to be able to focus and thus limit the number of models? Or is choosing more than one model a well thought strategic response allowing them to distinguish themselves and compete with the large enterprise on the global chessboard?

Theory on profit models was elaborated and validated from the world of many large enterprises. Yet, according to this research, theory on profit models does not always stick to a reality found and lived in the SME context. Would it not be appropriate to take note one more time of the great divergences, which exist between managerial modes in SME versus corporate management in large enterprises? All things considered, the many questions raised by this exploratory study warrant new studies on the subject even if they were looked in dept in the field of entrepreneurial studies.

This article shows the justification for further studies to answer these questions. For one thing, it will certainly help SME managers to improve their management practices and reach higher performance results, and secondly, it will help the scientific community to better understand the profit model theory and its applicability to the SME world.
References