

Opportunities and pitfalls related to e-commerce strategies in small–medium firms: a system dynamics approach

Carmine Bianchi^a and Enzo Bivona^{b**†}

Carmine Bianchi is Full Professor of Business Management at the Faculty of Political Sciences, University of Palermo. He is director of the Masters course on: “Managing Business Growth through System Dynamics & Accounting Models”, and of the doctoral programme in Business Management. He is also the scientific co-ordinator of CUSA-System Dynamics Group, and partner of Business Dynamics S.r.l. He has previously worked in Andersen Consulting. His main research and consulting areas are related to small business growth management, entrepreneurial learning, start-up, matching system dynamics with accounting models, dynamic scenario planning and balanced scorecards. On the above subjects, he is the author of several publications.

Enzo Bivona is attending a doctoral programme in Business Management at the University of Catania (Italy). He also collaborates as researcher with CUSA—System Dynamics Group,

Abstract

E-commerce is often perceived as a powerful lever to foster growth of SMEs. However, both the literature and empirical evidence have shown the perils hidden in superficial decision making by SME entrepreneurs. A system dynamics (SD) approach is used in this article to demonstrate how managing processes of accumulation and depletion of strategic assets, detecting inertial effects of decisions made in the past, and selectively acting on policy levers are likely to help entrepreneurs in understanding opportunities and pitfalls related to e-commerce strategies.

A feedback analysis of three case studies selected from the literature and the main findings from a survey conducted by the authors on SMEs pursuing e-commerce strategies are discussed. Based on the insights developed through this analysis, the last section of the article shows a generic SD model aimed to help entrepreneurs to better understand processes of accumulation and depletion of strategic assets, in SMEs' e-ventures. Copyright © 2002 John Wiley & Sons, Ltd.

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Introduction

Over the last decade, e-commerce has been used as an important lever to foster business growth. In fact, it has allowed firms to pursue global strategies, establish a direct relationship with end-consumers, shorten logistic channels and broaden potential markets.

Many successful stories are spread through the management literature (Drennan and Kennedy 1999; Easton 1999; Lowry *et al.* 1999; Tsai 1999) and the press have been encouraging a growing number of small–medium enterprises (SMEs) to start e-commerce ventures in order to increase sales turnover. However, such ventures have not always allowed SME entrepreneurs to achieve their intended results. In fact, different surveys have demonstrated a high mortality rate of small-businesses web sites.

What are the causes of such phenomena? What are the decision-making processes underlying growth-oriented e-commerce strategies undertaken by SMEs? What are the main risks an SME entrepreneur faces, e.g., concerning production capacity adjustment, financial policies related to investments in web-site development and maintenance, as well as to net working capital

^a University of Palermo (Italy), Faculty of Political Sciences—CUSA System Dynamics Group. Address: (c/o CUSA-System Dynamics Group), Piazza A. Gentili, 12, 90143 Palermo (Italy)

^b University of Catania (Italy), C.U.S.A.—System Dynamics Group, Piazza A. Gentili, 12–90143 Palermo (Italy)

* Enzo Bivona, University of Catania (Italy), C.U.S.A.—System Dynamics Group, Piazza A. Gentili, 12–90143 Palermo (Italy); E-mail: enzo.bivona@libero.it.

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Palermo (Italy). He received a MPhil. in System Dynamics from the University of Bergen (Norway). His research activities are mainly focused on small business growth management, matching accounting with system dynamics models, management control systems and balanced scorecards. He is the author of publications and microworlds on the above research fields.

associated with sales growth? What competencies should be built by an SME to manage its web site and to maintain a stable image? How does an entrepreneur perceive the above variables? What policy levers does he/she use to pursue Internet-based growth strategies? How are delays and non-linearities perceived?

In order to explore the above issues, the authors started a research project based on the following stages:

- 1 Analysis of the management literature and investigation of related case-studies on the field through a feedback perspective, aimed to build qualitative System Dynamics (SD) models.
- 2 Design of a field survey, aimed to test the assumptions developed in the previous stage.
- 3 Development of a generic SD simulation model,¹ based on the insights from stages 1 and 2.
- 4 Test of the generic SD model on the surveyed companies.

The research is still in progress: to date the generic SD model has been built and will later be applied to the firms participating in the survey.

This article aims to outline the findings generated so far from the first three stages. In order to provide a general framework for our study, the main critical success factors of SMEs' e-commerce strategies emerging from the relevant literature are initially outlined. Then, a qualitative feedback analysis of three case studies from the literature is presented. Such an analysis aims to depict the main forces driving the building and draining processes associated with strategic assets (Amit and Schoemaker 1993; Dierickx and Cool 1989) in e-commerce growth strategies.² The quantitative generic SD simulation model, based on the qualitative analysis and the field survey, is finally shown. The main research findings and implications for further research are summarised.

One of the main issues emerging from our study is the difficulty of entrepreneurs to timely perceive limits to growth arising from the lack of strategic assets. Although this phenomenon can also be detected in larger enterprises, it is particularly critical in smaller firms. In fact, quite often SMEs face structural difficulties in pursuing Internet-based strategies, owing to their own specific complexity features (Bianchi and Bivona, 2000) such as:

- lack of professional management;
- weak information and management control systems;
- decision-making processes mainly based on flair for business and gut feeling;
- lack of equity and financial resources;
- a weaker competitive position against larger firms.

Flaws in owner-entrepreneur's mental models and the lack of a professional team and management control tools can be primary causes of weak decision

making, leading to uncontrolled growth and unexpected crisis. For instance, delays in invoicing or deficiencies in handling growing volumes of data can be a primary cause of longer sales collection delays and higher costs (see cases 1 and 2 discussed below). Likewise, an increase in sales orders generated by aggressive commercial policies (e.g., web site promotional investments) can give rise to bottlenecks in production and shipping, leading to a gradual rise in delivery delays (see case 3). Such phenomena generate a slow and gradual depletion in business strategic assets (e.g., customer base and business image), which cannot be financially measured, owing to the weakness in conventional management control tools (Bianchi *et al.* 1998).

SD modelling can support decision makers in understanding the dynamics of such resources, as a result of a learning process through which it is possible to better frame the relevant system and question the consistency of mental models (Morecroft 1994; Sterman 1994).

The main critical success factors of SMEs' e-commerce strategies

The development of e-commerce in the last ten years all over the world has involved a growing number of businesses, as well as researchers. According to Forrester Research (2000), it has been estimated that in the year 2000, business-to-consumer online sales in the USA have been about US \$40 billion and by 2004 could reach US \$200 billion. It has also been estimated that in the year 2000 the volume of transactions in Europe reached US \$12.5 billion and in the next two years it could be four times higher (Warburg Dillon Read, 2000).

A report from Philips Group emphasises that most European SMEs are not yet prepared to deal with e-commerce. Only 12 percent of them have developed and applied an e-commerce strategy, and 40 percent have not defined any Internet strategy at all (Nua Internet Surveys 2000).

A survey conducted in Europe by the KITE consortium (1999), noted some critical success factors related to small-business e-commerce strategies. Some of the most significant are:

- *content*, i.e., the presentation of a product or service offered over the Internet in a way that is attention-grabbing and compelling;
- *convenience*, i.e., usability of the web site for the purpose for which it was designed;
- *control*, i.e., the extent to which the business is able to monitor significant processes related to e-commerce, such as delivery, customer queries and information updating;
- *interaction*, i.e., the attitude of the firm to building effective relationships before and after sales;

- *community*, i.e., the capability to attract and maintain a group of like-minded individuals/organisations, sharing information and services (e.g., through databases);
- *price sensitivity*, i.e., a proper balance between price and quality of offer provided;
- *brand image*, i.e., the ability to build up a brand name;
- *commitment*, i.e., a strong motivation for using the Internet as a lever to innovate;
- *partnership*, i.e., the attitude of companies to start and develop long-term relationships with other firms, for instance to broaden product portfolio and customer base.

Another important success factor we have detected in our survey is the need for a long-term perspective to evaluate the financial profile of e-commerce investments.

Managing SMEs' growth in e-commerce ventures: a "feedback-oriented" resource-based view

In order to pursue sustainable e-commerce strategies, the entrepreneur ought to take a systemic view of the above critical success factors. Each of them is dynamically linked with others and arises from the accumulation and depletion processes affecting strategic assets. This implies that successful growth may not be achieved if decision makers are prone to react emotionally to contingent events. This phenomenon is quite common when new e-commerce ventures are started by SME entrepreneurs (KITE 1999).

For instance, in order to gain a competitive advantage based on the *community* factor, entrepreneurs may foster those processes enlarging the business customer base, regardless of the capability of the firm to handle the growing number of customer queries. As a consequence of this policy, the development of a *community* is achieved to the prejudice of *control* and *brand image* in the long run.

Consequently, to manage Internet-based growth strategies properly, it is crucial to foster decision makers' learning about processes of accumulation and depletion of strategic assets. These processes are often difficult to perceive, not only because they cannot be measured in monetary terms, but also because they gradually evolve over time and are subject to inertia. In fact, the current level of a given strategic asset is the result of implicit or explicit decisions that could have been made a long time in the past.

In the following sections, three case studies will be analysed to depict growth and decline processes in SME e-commerce ventures. All of them demonstrate how SMEs' growth and failure in Internet-based strategies can be explained from the perspective of process of accumulation and depletion of

strategic assets. Such assets are often intangible and specific to the e-commerce field. In particular, Case 1 emphasises the role of entrepreneur's available time for handling customer queries and banners as typical strategic assets affecting business success. Case 2 focuses on the differentiation between web-site visitors and customers, contacts with other web sites, time devoted to managing company items, a query database and mailing lists. Case 3 highlights the relevance of web site investments, business contacts and standardisation of sales orders.

As the final section of the article will show, the above strategic assets and the findings from our survey provided the basis on which the generic SD simulation model has been built.

Case 1: Ask The Builder

In December 1995, when e-commerce was still almost unknown, a professional builder and remodeller, Tim Carter, started to dream of opening a web site to supply customers with professional advice, tips and resources related to home improvement. For this reason, he decided to launch *Ask The Builder* (Easton 1999), a micro-firm financed through a line of credit he established on his house.

Some years before starting the firm, in order to contact new customers, Carter used to advertise his professional advice through newspaper columns. However, he felt that a larger potential market, and quicker and direct contact with the public, could be reached through the Web.

Although two main products were sold through the web site, the main source of income for the company was related to revenues from banners sold to building companies.

A first problem faced in the start-up stage was related to the web-site design and set up. Because of the lack of available financial and human resources, Carter decided to ask for the support of two consultants. This allowed him to develop new skills in web-site design and maintenance, so that later he was able to give up home improvement consulting services.

Different media were used to advertise the *Ask The Builder* web site, in particular through newspaper articles and Carter's frequent appearances in print and on TV. In a few months, the number of web-site visitors started to grow exponentially, up to 12 000 pages viewed per month. Carter feels that the success of his site is not related to the number of visits, but is due to the personal contact he has been establishing with clients. He receives on average more than 50 messages per day. This is a very time-consuming activity for Carter, who strongly believes that customised and detailed responses are a powerful lever for fostering customer loyalty. Most of the queries received by Carter are highly detailed communications requiring careful replies.

When *Ask The Builder* was started, Carter used to check his mailbox, on average, once a day. Two years later, due to web-site traffic increase and banner advertising requests, he was forced to check e-mails every 90 minutes.

Such a phenomenon may disclose a potential problem, as Carter—being supported by only part-time staff—was finding it more and more difficult to manage his time. This could be a threat for the company in the future, provided that a prompt and customised reply is a critical success factor. An implication of this is that further growth in activity volumes could be sustainable in the future only through the acquisition and training of human resources able to fulfil the tasks actually performed by Carter.

What are the driving forces of business growth? What symptoms will allow the entrepreneur to promptly discern limits to growth?

If we analyse the firm as a system of strategic assets, i.e., as a coherent body of production factors providing the basis of competitive advantage, we can describe business growth through feedback loops affecting resource dynamics over time. Each strategic asset, depicted as a *stock*, is likely to change over time as it is influenced by *flows*. Such flows are originated by business policies aimed to deploy a given endowment of currently available resources (Warren 1998). For instance, the acquisition of new customers (stock variable) depends on the allocation of human-resources time available (stock variable).

According to the SD methodology, it is possible to depict the main feedback loops fostering and tackling *Ask The Builder's* growth, as shown in Figure 1. Although the figure displays stock and flow variables, it does not aim to represent a segment of a quantitative simulation model. It is, rather, a qualitative representation of those processes of accumulation and depletion of strategic assets lying behind an e-commerce venture. Consequently, the related time graphs that will be shown later are not the result of simulations; they only show the patterns of behaviour generated by such a qualitative analysis.³

The outer loop captures the growth process pursued by the company. Web-site set-up and promotion investments allow Carter to provide clients with a satisfactory service. The initial customer base generates a word-of-mouth effect leading to a further increase in business customers. The higher customer level fosters the sale of banners, which increases cash flows, which can be reinvested in further web-site improvements.

However, in the medium term, the above increase in customer base will affect business service. In fact, the higher number of queries Carter has to deal with on a daily basis gradually reduces the average time devoted to each customer. Although this phenomenon is currently insignificant and is not perceived either by clients or by Carter, it is likely to generate a limit to growth and subsequent collapse, as it will reduce the customer acquisition rate and, consequently, the customer base (Figure 2).

Fig. 1. The main feedback loops fostering and tackling *Ask The Builder's* growth

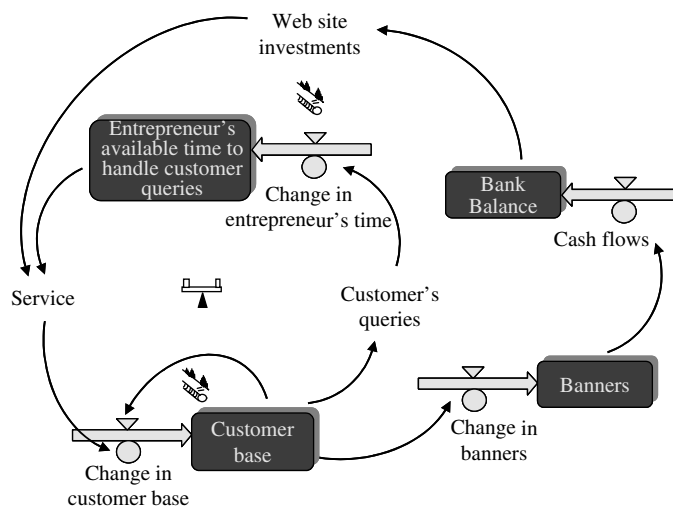
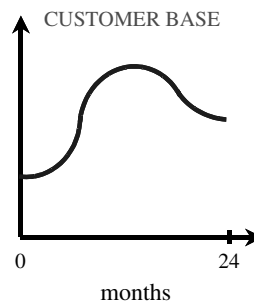


Fig. 2. Customer base dynamics



How will the firm be able to face the above limits to growth? What strategic assets will the company have to build in order to counterbalance such limits?

The main strategic asset tackling growth is related to skilled human resources. The acquisition of such resources is tied to the availability of other resources, such as financial assets and entrepreneur's time to deal with customer queries (Figure 3). Even though, in this case, financial resources are not a significant problem, provided that banner revenues are a major source of cash flows, entrepreneurial time is the scarce resource that will be likely to limit further growth. As a matter of fact, in the short term, a progressive allocation of Carter's time to train new employees will reduce even more the time he will devote to handling customer queries, which will decrease the level of service. However, in the longer run, new trained staff will be able to support Carter to overcome the above limit to growth, through service improvement leading to further development of the business (Figure 4).

- acquire a mind-set oriented to figuring out short- and long-term effects arising from adopted policies; they must be aware that the attainment of satisfactory results in the long run can often be achieved only by worsening short-term results, and vice-versa;
- adopt a feedback view of strategic assets, in order to assess sustainable business growth policies.

Developing an attitude to perceive weak signals of strategic change in time is crucial for SMEs' survival and growth. In fact, as remarked in the introduction, owner-entrepreneurs are not usually supported by a professional management; this forces them to deal simultaneously with current and strategic issues.

The above attitude is particularly significant when strategic surprise may arise from the bundle of current activities, rather than specific long-term projects. In fact, monitoring strategic relevance of current events often implies major difficulties in detecting in advance weak signals of change, as they are usually hidden in a wider range of daily occurrences in which decision makers are fully involved.

Case 2: Coastal Tool & Supply

In October 1995, Robert and Karen Ludgin started *Coastal Tool & Supply* (Easton 1999), an e-commerce company selling tools such as drills, saws, routers, sanders, polishers, rotary and demolition hammers and other tools for home improvement.

To start the company web site, they hired Todd Mogren, a 36-year-old with a computer background in database management and a love of home hardware. Although the business owners are Robert and Karen, Todd can be considered the entrepreneur, as he is in charge of the most significant decisions impacting on the company's growth.

The business mission is to provide clients with a wide product scope at a competitive price and online assistance. Consequently, when *Coastal Tool & Supply's* web site was designed, Todd focused on two major goals:

- a friendly interface and a standard layout;
- a fast and easy purchasing process.

Todd's slogan is "Three-Clicks-to-Buy": as a business policy any customer should be able to add to the shopping cart within three mouse clicks. This makes the selling process more comfortable, as in real shops. As the number of items at the site is growing continuously, Todd always checks to see whether the "Three-Clicks-to-Buy" holds true. This is a very crucial aspect for the business growth management.

The quality of the business offer is also enriched by a service package, such as:

- free counselling to clients on the kind of tool to choose according to specific needs, and
- a wide and diversified database including past answers to client queries.

From 1996 to 1997, such an offer allowed the firm to increase its sales revenues by 474 percent and in 1998 to earn a profit higher than US \$1.5 million. However, the business start-up was not easy; in fact, the first order was not received until six months after the web site opening. Surprisingly, the slow start did not worry Todd. As a matter of fact, he was aware of the huge potential market that the Internet would have allowed the firm to reach.

In contrast, he was astonished by the enormous workload generated by sales orders management.⁴ This activity does not only imply administrative and physical order handling, but also concerns a personal contact with each customer. This is a very critical task, provided that each visitor receiving a satisfactory reply to his query will certainly send a purchase order.⁵

In order to increase the web-site traffic, the company has been acting on other policy levers aimed to build up two important strategic assets:

- a network of reciprocal links with other companies operating in similar industries; and
- an electronic mailing list, including about 20 000 addresses, to which a monthly newsletter is sent.

Through the mailing list, the company has increased customer loyalty as a consequence of a higher perceived service quality. Another effect generated by the mailing list is related to the revenues provided by newsletter banners sold.

A side effect of the growing number of items embodied in the web site (about 4000) is the increase in inventory. In this regard, Mogren is not concerned about the higher financial costs related to inventories or available warehousing space; he is worried, instead, by the time needed to handle the volume of items offered on the web site.

An analysis of the opportunities and pitfalls related to *Coastal Tool and Supply's* e-commerce strategies can be supported by a feedback view of building and draining processes affecting its strategic assets.

A reinforcing loop underlying business growth can be related to the accumulation of new items in the product portfolio of the firm. In fact, an increase in the scope of items sold leads to a higher average order per client. As a consequence, both cash flows and—other things being equal—bank balance increase. An improvement in the company liquidity fosters a further increase in the scope of items sold (Figure 5).

Fig. 5. Effects of an item-increase policy on business growth

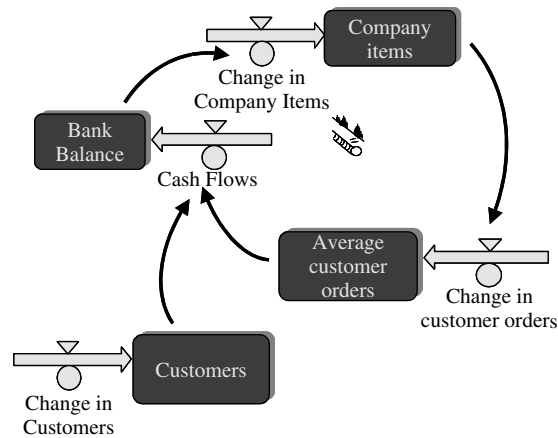


Fig. 6. Effects on business growth generated by reciprocal links, web-site quality and customer loyalty policies

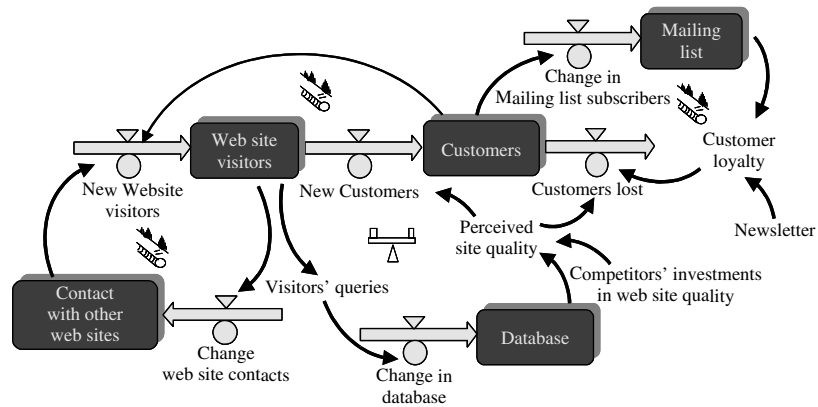


Figure 6 depicts other reinforcing loops fostering business growth, which are related to commercial policies aimed at increasing the number of visitors, improving perceived web-site quality and fostering customer loyalty.

The progressive growth in Todd's personal contacts with web-site owners selling similar products generates a higher new company visitors rate. The stock of company visitors (i.e. people interested in buying company items) is another strategic asset critical to business growth. In fact, visitors influence business performance in two different ways:

- 1 They generate a critical mass of traffic, which makes the company's web-site more attractive for new reciprocal links with other sites.
- 2 They give rise to a higher volume of queries, leading to a larger database. This increases the site's perceived quality, generates new customers and enlarges

the customer base. A higher customer base fosters, through word-of-mouth, an increase in web-site visitors, leading to further growth.

A minor balancing loop may impact on web-site visitors. In fact, an increase in new customers caused by higher perceived site quality reduces the pool of visitors if the inflow of new web-site visitors is lower than the outflow.

The draining effect generated by the balancing loop can become more significant if the positive loop associated with the word-of-mouth phenomenon is weakened by a lower perceived web-site quality, due to better services provided by competitors. In fact, this can give rise to a higher rate of customers lost, which reduces the customer base.

In order to tackle such threats, Todd fosters customer loyalty by inducing clients to subscribe to the mailing list. The larger the number of addresses stored, the stronger will be the effect of the newsletter on customer loyalty.

The dynamics generated by the feedback loops described above are depicted in Figure 7.

What pitfalls can be related to Coastal Tool & Supply future growth?

Further growth could be tackled by other strategic assets, such as, for instance, time devoted by company personnel per company item and business liquidity.

In fact, the more items are offered, the more will be the time needed to update the company web site. If the firm does not increase its endowment of human resources, the average time devoted to give advice on each item will decrease. As a consequence of this, the perceived site quality will drop, leading to a

Fig. 7. Limits to growth and further expansion generated by perceived web-site quality and customer loyalty

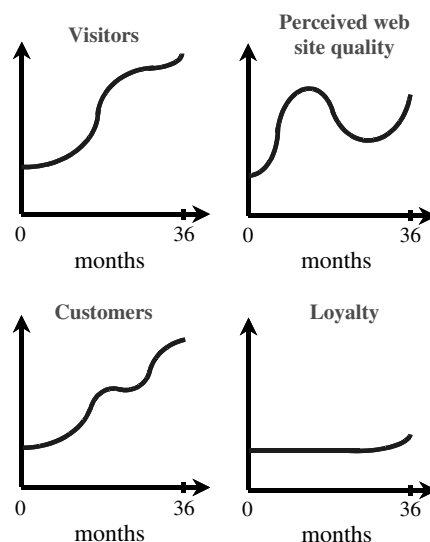
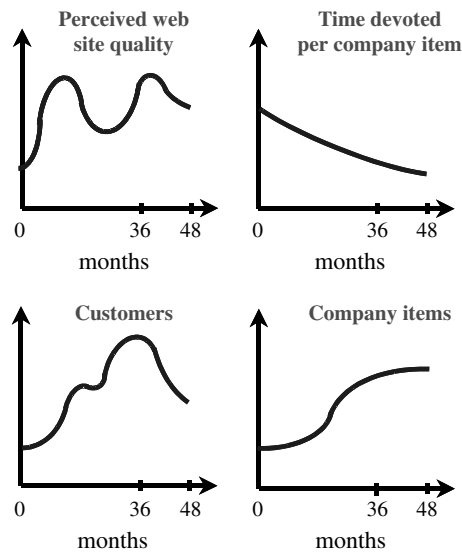


Fig. 9. Limits to growth generated by time devoted per company item and business liquidity



railway stations and other firms that needed to move people or goods quickly and cheaply from one place to another. Based on the quality/price ratio, the product was positioned in a medium-high market segment.

Carlo was in charge of commercial activities, Angelo and Maria were respectively devoted to product design and purchasing/production. Carlo acted as the entrepreneur, the other two partners did not devote much time to strategic decision making and the firm did not rely on a professional management.

In order to overcome the lack of sensitivity of the domestic market towards business environmental responsibility, the firm started an internationalisation process and opened a web site. The entrepreneur began travelling all over the world to contact potential end-consumers and distributors. The web site opening not only contributed to increasing the company visibility, but also provided new customers from Internet "surfers".

In 1997, the firm signed an important commercial agreement with Zap Power System. This allowed it to increase sales revenues significantly, from US \$35 000 in 1995 to US \$400 000 in 1996. Staff employed in the production area also increased, from four to 25 people.

As the factory was relatively small, Angelo and Maria tried to rationalise available space, both in production and inventory processes. While component parts were received from outside suppliers, the scooters were designed and assembled inside the factory.

The entrepreneur's goal was to become a first-in-class competitor in the world, to increase sales volumes in order to saturate available production capacity. To reach this goal, he was inclined to accept any new order

from different countries, although it may have required a higher product customisation aimed to fulfil the various law prescriptions. About 95 percent of production was sold abroad, mainly to Japan, USA, Singapore, Malaysia and different European countries.

In the middle of 1997, perhaps nobody could have imagined that the firm would go bankrupt!

How can one explain that such a fast growing business would have collapsed?

The main cause of business failure was the lack of standardisation in sales orders accepted by the entrepreneur, who did not worry about production capacity constraints. Consequently, although he was prone to guarantee clients a reliable delivery delay, he was forced to postpone the shipment of products sold because of unmanageable production problems.

The gradual rise in delivery delays generated two main side effects:

- financial shortages, due to delayed invoicing and sales collection, and
- eroding business image, which in turn affected product demand.

In spite of the above difficulties, Carlo was confident that he would honour business commitments, even though payments to suppliers and shipments would have been slightly postponed.

Unfortunately, it happened that the slow and progressive erosion in business image negatively affected the relationships with suppliers, customers and banks, leading to a deep insolvency state.

The phenomena depicted above generated an unbearable burden that finally Carlo was not able to sustain. His autonomy in managing the company—initially perceived by him as a strength—became a primary factor of loneliness.

Figures 10, 11 and 12 depict the main feedback loops underlying *Movity's* growth and decline processes.

Figure 10 shows how an increase in business contacts, resulting from promotional efforts and initial web-site investments, increases sales orders as well as—and other things being equal—shipments and cash flows. Higher bank balances allow the company to improve web-site quality and to increase business contacts. This improves image and leads to new contacts and further growth.

Over a longer time horizon, the progressive growth in business contacts generates a higher internationalisation level of the company. This phenomenon, matched with uncontrolled commercial policies, reduces standardisation of sales orders, which increases delivery delays. Consequently, shipments and cash flows decrease, and generate a lack of financial resources to self-finance web-site improvement (balancing loop in Figure 11).

Fig. 10. *Movity*'s growth processes

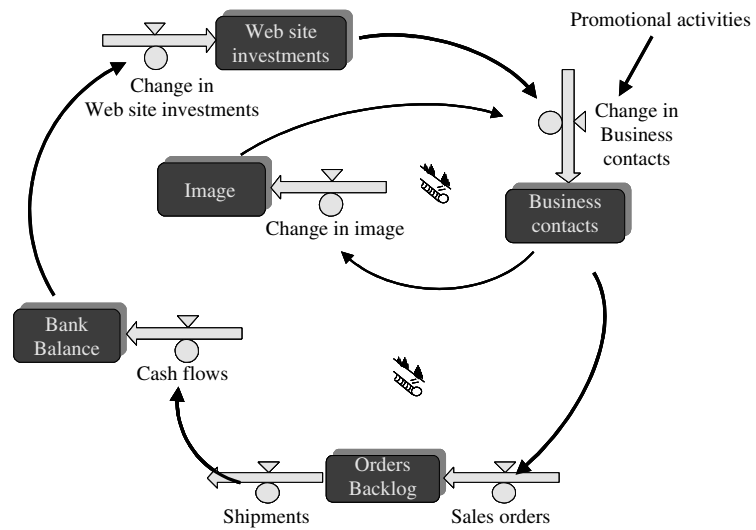
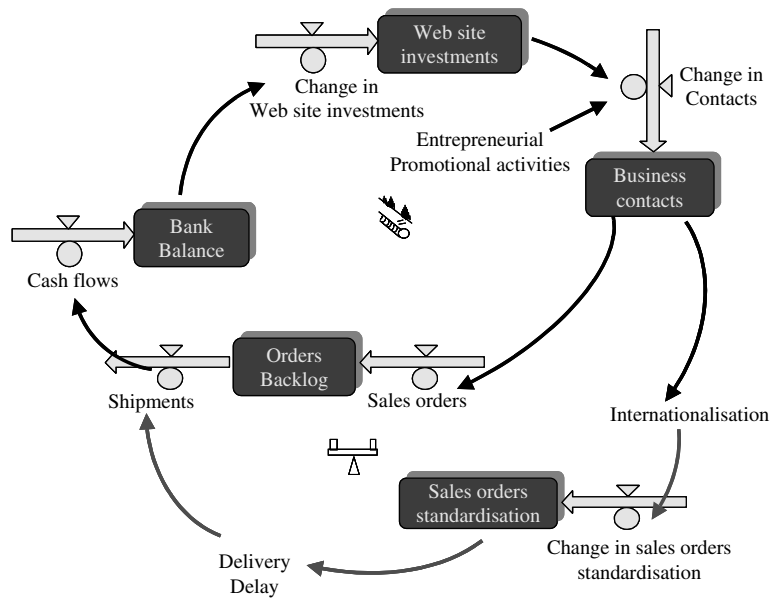


Fig. 11. Limits to growth generated by an increase in delivery delay



From the above analysis it is possible to argue that, in order to prevent crisis and effectively manage growth, the entrepreneur ought to perceive weak signals of change in time. In the *Movity* case study neither the business control system's sensitivity nor the entrepreneur's mental models were able to detect warning signals related to the above phenomena.

Fig. 12. Undetected balanced feedback loops leading to failure

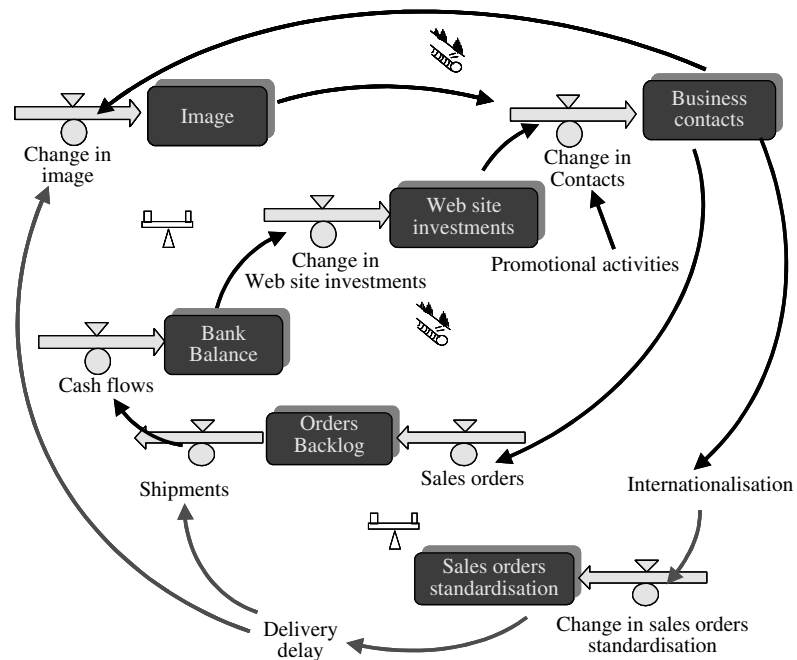


Figure 12 illustrates feedback loops leading to the failure of *Movity*.

Lack of prompt perception of the balancing loop tackling growth, related to delivery delay effects, leads the company to strengthen investments in web site and promotional activities, aimed to foster a further expansion of business volumes. Such a policy increases, on the one hand, sales orders and cash flows. However, on the other hand, it also gradually leads to a further rise of delivery delays recognised by the market (Forrester 1968). When such delays cannot be tolerated any longer by clients, the business image declines. This reduces business contacts and sales orders, and leads to financial crisis.

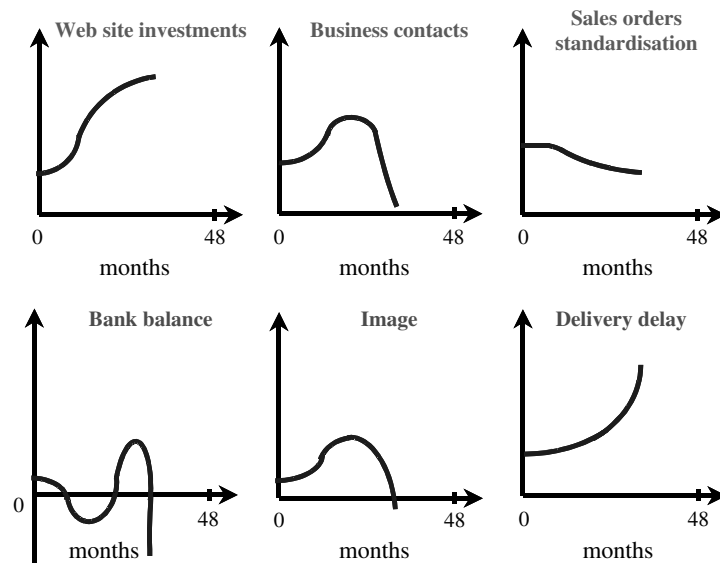
The feedback loops discussed above provide a system structure from which the dynamics portrayed in Figure 13 originate.

What can an entrepreneur learn from the three case studies analysed above?

In order to manage properly SMEs' growth and decline processes in e-commerce ventures, it is necessary to:

- develop an attitude to perceive promptly weak signals of changes affecting the dynamics of strategic assets (e.g. decreasing time to handle customer queries, rising competitors' investments in web-site quality, declining product standardisation);

Fig. 13. Strategic assets dynamics related to growth and failure of *Movity*



- be aware of short-vs long-term effects generated by policies adopted (e.g., effects of customer-base dynamics on human resource policy, rising financial needs caused by increasing company items);
- detect reinforcing and balancing loops affecting the dynamics of strategic assets, in order to strengthen those enhancing growth and weaken those limiting it (e.g., positive loop in Figure 5 and negative loops in Figure 8);
- understand that the dynamics of strategic assets is difficult to perceive and affect, mainly because of their intangible nature and inertial effects generated by delays and non-linearities.

Overview of a survey conducted on SMEs pursuing e-commerce strategies and related summary results

The analysis of case studies given in the literature shows how detecting the feedback structure linking different strategic assets discloses the deep causes underlying growth and decline processes in SME's e-commerce ventures.

In order to test the assumptions emerging from the case-study analysis, we conducted a survey of 200 SMEs, mainly operating in Italy in various industries, ranging from food to handicraft, fashion to services, etc. Companies have been selected from databases available in portal web sites and entrepreneurs' associations of different provinces. Provided that the survey has been focused on businesses selling their own products or services through the Internet, portals have not been included in the sample.

Two different questionnaires⁶ aimed at detecting both decision makers' perceptions about key management areas and recurring problems associated with SME's e-commerce ventures, were sent by e-mail to the surveyed companies in two sequential steps. Forty companies from different industries replied to the first questionnaire. Only eight of them returned the second questionnaire. Data from these companies have not only been gathered through the questionnaires, but also through on-site and phone interviews with entrepreneurs and other business decision makers.

Although the selected sample is not statistically representative, it allowed us to get more insights on how the e-commerce phenomenon is faced by small business entrepreneurs and collaborators.

About 70 per cent of interviewed entrepreneurs started their e-commerce venture to support their own existing activities, mainly focused on domestic markets and traditional distribution channels. Most of them perceive that e-commerce can better support their own companies in undertaking globalisation strategies without incurring prohibitive investments for SMEs. Many of them also complain about the lack of proper resources (e.g., information and control systems, management, capital) and the low propensity of their increasing number of web-site visitors to buy the company products or services.⁷

Quality and customer service have been mentioned as most important levers on which to act in order to be successful in e-commerce ventures. However, advertising and information systems are also considered as powerful levers.

Furthermore, managing customer relationships (e.g., handling e-mails) and searching for new contacts in the competitive system (e.g., establishing partnerships with competitors, suppliers or investors) have been indicated by interviewees as activities to which they are used to devoting most of their time.

The survey findings strengthened our original assumptions and encouraged us to build a generic SD simulation model aimed at providing SME entrepreneurs with a viable tool to explore alternative scenarios in e-commerce ventures.

A generic SD simulation model to analyse growth and decline processes in SMEs pursuing e-commerce strategies

A generic SD simulation model has been built in order to capture those most relevant issues that emerged from the case-study and field analysis.⁸ In order that it can be applied to the surveyed companies, the model embodies an input window that allows decision makers to calibrate the model for the specific context in which they operate. The input window includes four sections: market (e.g., number of visitors who browsed the site in the last year, demand sensitivity to delivery delay and post-sale assistance); commercial (e.g., search engine subscription unit cost, company and main competitor's product unit

price); finance (e.g., web-site capitalised costs); and internal processes (e.g., number of employees managing queries).

The simulation model has a time horizon of 200 weeks. Such a period has been set to capture the short- and long-term effects that SMEs' e-commerce strategies are likely to generate. From our survey it emerged that the novelty of the e-commerce phenomenon for SMEs, its changing complexity and its unpredictability make extremely hard any reliable assessment of future events going beyond three–four years.

Figure 14 shows the stock and flow diagram describing the building and draining processes affecting the dynamics of the main strategic assets in a company undertaking e-commerce strategies. Such strategic assets (e.g., occasional visitors, visitors, visitors willing to buy, customer base, mailing list) have been defined according to the results of the case-study and field analysis.

The model shows that those people who initially get in contact with the firm, through its web site, come from a pool of potential visitors who could be interested in company products. In order to foster the occasional visitor's increase rate, the firm can act on two main policy levers: advertising in industry-related magazines and subscription to search engines. Furthermore, word-of-mouth effect generated by the current stock of customers may accelerate the influence of the above two levers.

The stock of occasional visitors is depleted both by the flow of people who like the web site and become regular visitors and by those who do not find the company offer useful, thereby increasing the level of potential visitors.

In order to increase the rate of new regular visitors, the company can act on two other important policy levers, i.e. the number of employees devoted to dealing with visitors' e-mails to increase perceived service and the product scope offered through the web site. The higher the product scope, the higher will be web-site attractiveness; however, too high a product scope will be likely to misplace visitors.

On the other hand, in order to tackle the loss of occasional visitors, the company can improve the quality of the web site through new investments (e.g., design, speediness, attractiveness). This assumption implies that web-site investments are a necessary prerequisite for undertaking e-commerce ventures. Conversely, such investments can counteract the loss of occasional visitors, who may be attracted by the quality of the web site.

Once visitors have been attracted into the company web site, price becomes the primary lever on which to act in order to drive them into buying company products. However, the stock of visitors could decrease because of the lack of service provided by personnel devoted to handling e-mail queries.

Nevertheless, price is not a sufficient lever to induce visitors to buy company products; it is only a prerequisite for purchasing. Two other issues impinge on the final decision for visitors to send an order: post-sale assistance and delivery-delay reliability. In fact, such performance indicators significantly shape the business image in the company's market.

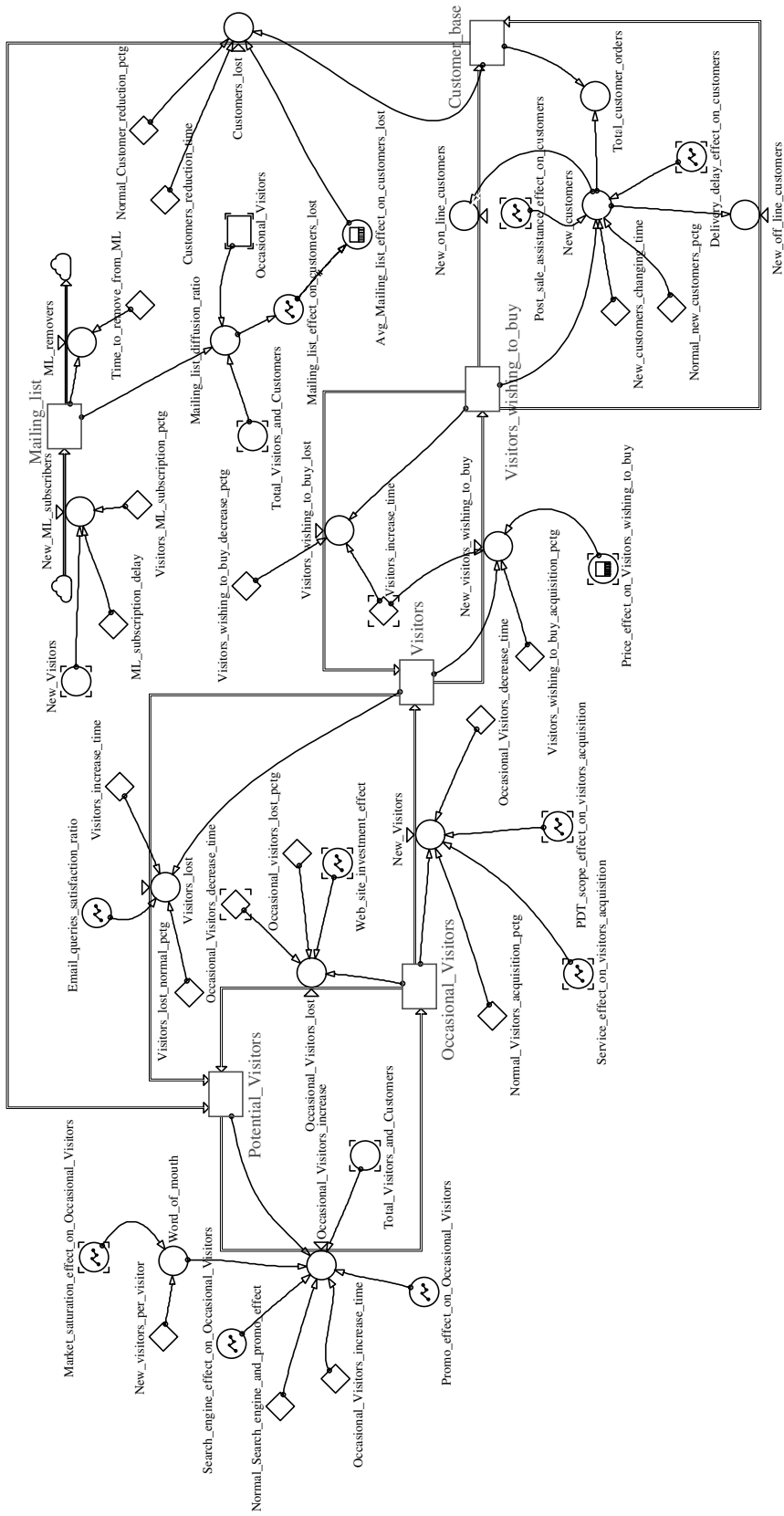


Fig. 14. Stock and flow diagram related the accumulation and depletion processes for visitors and customers

Company sales orders originate from two different sources: new customers and the current customer base. It is crucial for the firm to understand whether sales orders mainly originate from the first or the second source. In fact, if the customer repurchase rate is lower than new customers' average purchase rate, and the flow of new customers is decreasing, the firm could experience a rising customer base and declining sales revenues at the same time. Provided that it is a common practice in e-commerce to evaluate business performance according to the visitors and customer base levels, an undetected decreasing new customer orders rate could generate a crisis, the causes of which would be eventually difficult to understand.

Normal customer-base decrease rate is counterbalanced by business policies aimed at building a virtual community among visitors and clients, thereby fostering customer loyalty. For example, this effect can be generated by mailing lists.

The relevance of the SD approach in portraying the acquisition and draining processes discussed above that affect strategic assets in e-commerce ventures originates from its support in explaining the *physical structure* of the relevant system. A structure consisting of several sequentially interconnected levels implies a chain of delays, which can generate unpredictable oscillations in the behaviour of strategic assets, leading to an unmanageable system (Forrester 1961; Sterman 1989).

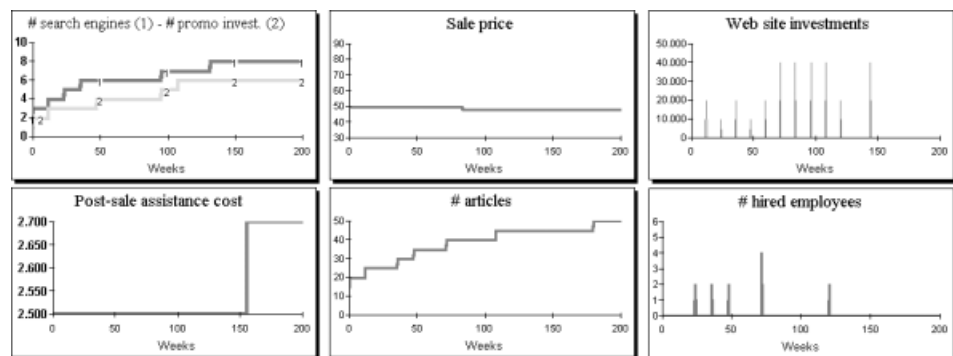
In order to manage an e-commerce venture effectively, entrepreneurs must be aware of the feedback structure underlying business processes. They must be also able to act selectively on different policy levers affecting the accumulation and draining processes of strategic assets depicted in Figure 14.

Figures 15, 16 and 17 show the main feedback loops, key-variable dynamics and decisions associated with a strategy pursued in an e-commerce venture. The main policy levers affecting the dynamics of visitors and customers are: search engines; promotional investments; sale price; product scope; and post-sale assistance.

A base run of the generic SD model shows that an enlargement of the product scope, supported by investments in search engines, advertising, web site and personnel, is likely to foster an increase in new visitors, leading to more customers and a rise in orders and cash flows. This, in turn, provides funds to finance further growth. The reinforcing loop showing this in Figure 15 is strengthened by two other major feedback loops. One of them is related to the mailing-list effect, which reduces the flow of customers lost. The second feedback loop refers to the word-of-mouth effect generated by the existing customer base, leading to a further acquisition of occasional visitors, providing a source of new visitors and customers.

A side-effect produced by an increase in product scope gradually generates difficulties in inventory and purchase-order management. This leads to higher delivery delays and a decrease in new customer acquisition.⁹ Such a phenomenon causes a decline in sales orders and cash flows, which generates

Fig. 17. The main decisions in a base run



In order to stabilise the oscillations experienced, the company finally undertakes a post-sale assistance policy. However, although this improves both income and bank balances, it does not allow the firm to pursue sustainable growth as its product scope has become too large, if compared—at least in the short/medium term—to the business service capacity (Figures 16 and 17).

Concluding remarks and implications for further research

This article has outlined the main findings of a research project on the opportunities and pitfalls related to e-commerce strategies in SMEs.

In order to focus the context of our analysis, the main critical success factors of SMEs' e-commerce strategies have been initially discussed, as they emerge from the literature.

Three case studies described in the literature have been selected and debated in a feedback perspective of SMEs' processes of accumulation and depletion of strategic assets. Such an analysis allowed us to outline some critical strategic assets (e.g., entrepreneur's available time to handle customer queries, a query database and mailing lists) that are peculiar to the e-commerce context, whose dynamics may significantly affect SMEs' success or failure.

From the investigation of the case studies also emerged the importance of:

- promptly perceiving weak signals of change;
- discerning short-vs long-term effects from adopted policies;
- detecting reinforcing and balancing loops affecting the dynamics of strategic assets.

The main results from a survey conducted by the authors on SMEs pursuing e-commerce strategies have referred to a lack of resources, the importance of quality and customer services, as well as advertising and information systems as powerful levers on which to act. Other important issues that have been

noted are managing customer relationships and searching for new contacts in the competitive system.

Both the issues emerging from the case-study analysis and the survey findings encouraged the authors to build a generic SD simulation model to analyse growth and decline processes in SMEs pursuing e-commerce strategies. The structure of the model and a base run have been analysed in the previous section of the article, in order to show how a simulation tool can support SME entrepreneurs in acting selectively on different policy levers and exploring alternative scenarios in e-commerce ventures.

Further developments will involve new contacts with interviewed entrepreneurs, aimed at testing the model assumptions and experimenting with its likelihood of fostering SME entrepreneurs' learning in pursuing growth through e-commerce ventures.

Notes

1. By "generic model" we mean those simplified pictures of reality reflecting the broad processes (e.g., financial, production, distribution) of any firm, often related to a given industry (Lane and Smart 1996; Winch *et al.* 1997).
2. E.g., knowledge, image, financial resources, production capacity.
3. The same principle applies for all the other figures related to the three cases.
4. The firm receives on average 10 visitor's queries for each sales order.
5. Many orders are, however, transmitted by clients via fax or phone, as visitors are not confident about giving their credit card number through the Internet.
6. Neither questionnaires nor detailed survey results have been here presented, as their analysis goes beyond the purpose of this article. Such materials are available on request from the authors.
7. These findings are supported by other research projects conducted on the field: KITE (1999); The European Observatory for SMEs, Sixth Report (2000).
8. Model equations are available from the authors on request.
9. This is quite a recurring problem in e-commerce ventures. Both in our survey and in the press on e-commerce failures, bottlenecks caused by a rising product scope have been mentioned as a primary reason for customer dissatisfaction. For instance, in Italy, the main effect in the failure of Zivago (a company operating in book and CD-ROM e-commerce) was indicated as unreliable delivery delays. Marco Patrone, a dissatisfied client, accused the company of not being well organised in honouring promised delivery delays. He said: "I bought four times from Zivago: the first time everything was OK, but it was the 17th February 2000, the second time (17th June 2000) there have been some delivery problems (some books were missing), the third and fourth time (26th October 2000 and 7th November 2000) I was very angry as I didn't receive any feedback from the company even after 10 days from the expected delivery time. When I sent several e-mails to

protest and ask to receive immediately the goods, I was initially told that the problem was related to suppliers and other silly reasons. After I seriously got irritated, I received all the goods. However, I promised myself not to buy anymore from this company". (Zivago, 2000).

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