World Review of Business Research
Vol. 7. No. 1. March 2017 Issue. Pp. 58 – 68

Business Strategies for Small Firms and New Ventures

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Small firms and new ventures are important for national economies and increasing our understanding of how they can compete more effectively is essential for their survival. In this paper the business strategy literature is reviewed to come up with business strategies that small firms and new ventures can use to face the challenges of the marketplace. This topic is important because small firms have several disadvantages compared with their larger rivals due to their small size and they need to find ways to overcome in order to compete successfully against larger firms. Business strategies discussed include niche marketing, entrepreneurial judo, blue ocean strategy, underdog strategy, and gaining organizational legitimacy.

Field of Research: Niche strategy, Entrepreneurial judo, Blue ocean strategy, Underdog strategy, Gaining organizational legitimacy

1. Introduction

Developing strategies for small firms has been an active area of research in recent years (Ebben & Johnson 2005). Small firms are important for national economies and increasing our understanding of how small firms compete is essential (Baumol, Litan & Schramm 2007). One of the major challenges facing small firms is how to compete effectively against large competitors. Research shows that small firms suffer from a high rate of failure (Shane 2008). One of the reasons for the high rate of failure is that large firms are associated with certain advantages (Ebben & Johnson 2005; Yannopoulos 2010). These advantages include lower costs due to economies of scale, scope and experience, and greater market power manifested in terms of larger purchasing power.

Furthermore, large firms are admired by suppliers, customers, investors and distributors and are more recognizable and visible in their markets. Suppliers usually offer them better contracts. Investors are more willing to invest their money in a large company. Distributors are more than happy to carry products of large companies. Also, many customers prefer to do business with market leaders as they equate success with superior quality and perceive large companies as most successful. The existence of all these competitive disadvantages makes the task of competing effectively against large firms very difficult, as smaller firms need to find ways to overcome them.

But some management theorists including Hamermesh, Anderson, Jr. and Harri (I978) have conducted research into successful small businesses and questioned the pessimistic conclusion that it is difficult for small firms to survive and be profitable. These studies identified strategies used by small businesses that made them highly profitable. Therefore a large size or high market share is not always essential for higher profitability (Yannopoulos 2010). This research concludes that strategy is a powerful determinant of firm performance and that the strategy function differs in firms of different sizes (Woo & Cooper 1981, 1982). The research question in this paper is how to increase our knowledge of how small firms and new ventures can overcome their disadvantages and

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increase their chances of competing more effectively in the marketplace. The objective of this paper is to develop practical but evidence-based strategies to help small businesses and new ventures in their competition with other firms.

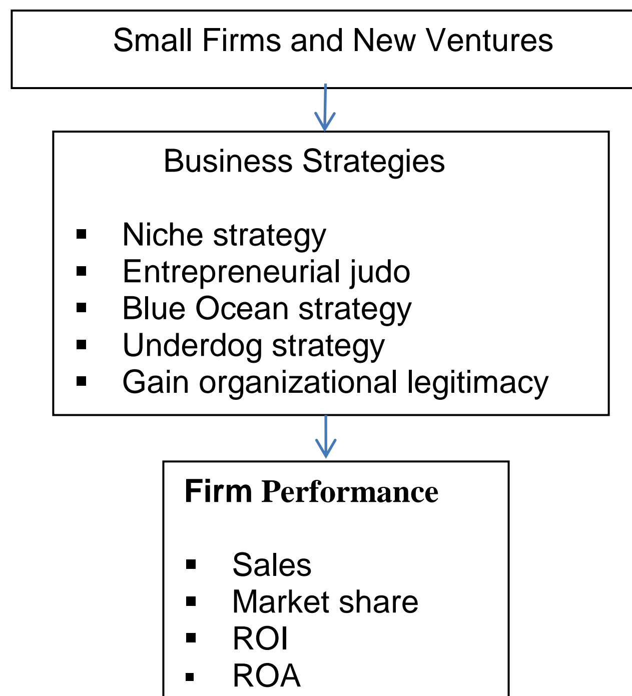
This paper recognizes that there is a gap in the literature and a need for research in the area of business strategy for small firms and new ventures. In this paper several business strategies are discussed that small firms can use to compete effectively against larger competitors. These strategies are developed on the basis of extensive review of the business strategy literature. The contribution of this paper is to uncover and discuss these strategies, and show how they can be effectively utilized by small firms and new ventures to overcome their small size disadvantages and successfully challenge their rivals. The findings in this paper differ from previous studies and this is the unique contribution of this paper.

The next section provides an overview of related business literature that includes several business strategies that small firms and new ventures can use to compete effectively and achieve market success. These business strategies include niche strategy, entrepreneurial judo, blue ocean strategy, underdog strategy, and gain organizational legitimacy. The last section of the paper includes the conclusions and managerial implications of the study.

2. An Overview of Related Literature

The business strategy literature is scattered with examples of strategies used by firms that help them compete successfully and even overtake their rivals. In this paper the focus is on those strategies that are suitable for small firms and new ventures so that their successful use can compensate for their small size disadvantage and achieve success?

Table 1: Business Strategies for Small Firms and New Ventures



As discussed in the introductory section, a selective review of the literature with a focus on business strategies appropriate for small firms and new ventures is conducted in this paper. This research question has not been addressed in past studies and this is an important gap in the literature. As such, past studies suffer from this limitation which the present paper intends to address. In the next section we review the relevant literature and distill the lessons drawn from research studies that examine successful business strategies. These strategies are discussed blow and new ventures and startups can employ to increase the chances of success and protect themselves from attacks by aggressive rivals. These strategies are shown in Table 1 which shows that organizational performance depends on the strategies pursued by these firms.

2.1 Niche Strategy

Studies show that successful small and medium sized enterprises primarily follow a niche strategy (Watkin 1986). Small firms often retreat to a niche where they rely on their in-depth knowledge of local conditions and the loyalty of their existing customers (Prashantham & Birkinshaw 2008). Other studies concur with this finding. Hamermesh, Anderson Jr. and Harri (1978) identified four successful strategies for small firms: (1) creative market segmentation and locating a profitable niche, (2) good leadership (3) controlled growth and (4) efficient use of R&D resources. Woo and Cooper (1981, 1982) found that low market share firms can be highly successful if well positioned and well managed and adopt strategies according to their capabilities and market requirements. Effective small businesses avoid the adoption of postures which parallel the strategies of effective high share firms.

Relationships among most competing firms are characterized by a great deal of strategic interdependence; that is, the outcome of a firm's strategy depends not only on the strategy it chooses but also on the strategy chosen by its rivals. Because of the mutual interdependence of firms in the same industry, it is not sufficient for an entrant to satisfy an unfilled market need with appropriate products; the entrant must be aware of its current and potential competition, moves and countermoves they may make, and what these competitors are likely to do next. According to Arreguin-Toft (2005) the nature of the strategic interaction among the rivals is the main determinant of the outcome of a conflict. When actors employ similar strategic approaches such as direct-direct or indirect-indirect, then relative resources explain the outcome of the conflict. Stronger rivals will win the battle quickly and decisively. When companies employ opposite strategic approaches such as direct-indirect or indirect-direct, small companies are more likely to win. Therefore, niche strategies are typically employed by firms that try to avoid direct competition with the market leaders and are looking to gain market share in specific market segments or products where the leaders are weak or not present. In other words, the successful small firm finds a niche in which the opponent is weak and, especially, niches whose needs are under-served or not served at all. As such, a niche strategy is an indirect type of attack, a form of flank attack that is commonly used by small firms against much larger opponents (Yannopoulos 2011).

Companies pursuing a niche strategy often have limited resources to compete broadly in the market. For this reason, a niche strategy is suitable for smaller firms, as it allows them to compete against the largest, broadly based competitors with only limited resources, and at the same time avoid a direct confrontation with them. In order for a firm to successfully compete in the chosen niche, it needs to possess or develop the skills and capabilities required to produce and market its product in the niche and successfully pursue its

strategy of satisfying the needs of the niche better than its competitors (Yannopoulos 2007). Furthermore, a company needs to match its skills and capabilities with niche and competitive requirements.

Furthermore, a niche strategy is appropriate when the market leaders occupy a strong position in the primary segments, but there is at least one other segment whose needs are either ignored or underserved. The small firm enters the neglected segment and develops one or more products designed to meet the needs of the segment, accompanied by appropriate pricing, distribution, and promotion strategies to stimulate demand for the products. Wal-Mart became the largest U.S. retailer by first focusing on small towns which had been neglected by the large department stores of the time, Sears, J.C., and Kmart Penney (Huang et al. 2012).

2.2 Entrepreneurial Judo

The entrepreneurial judo strategy is a dynamic version of the niche strategy. Entrepreneurial judo is appropriate for small entrants that have growth aspirations, but limited resources, because it avoids appearing threatening to the leader and the entrant's true intentions are not apparent to the leader, thus, minimizing the chances of a devastating retaliation (Yannopoulos 2011). It is also suitable for large entrants that want to avoid appearing threatening to incumbents, or are seeking to avoid the risks associated with a full scale entry (Williams 2007).

Entrepreneurial judo is best described by Gunther McGrath and MacMillan (2000) as follows: "The essence of the guerilla [entrepreneurial judo strategy or sequenced entry strategy] is to identify a niche in the market, preferably one that is underserved, and create a blockbuster attribute map for the niche that competitors will be reluctant to match. This niche then serves as a guerilla base from which you move into another niche, then another, and so on. If you are able to identify such niches, you may avoid the highly costly alternative of a full onslaught on the target arena. Niches are particularly useful for new entrants because they tend to be less visible and less threatening than an onslaught. The ideal reaction, especially from an incumbent combatant, is one that suggests the competitor doesn't perceive you to be a threat worthy of its concern. You will have the opportunity to build a substantial position before the competition notices that you are there."

Entrepreneurial judo allows firms with limited resources to successfully enter a market and compete against larger competitors, increasing their presence to the point that they are large enough to take them on directly. The premise of entrepreneurial judo is that entering a market on a narrow front is not usually viewed as a threatening move by large industry competitors (Yannopoulos 2011). Focusing on a niche makes the firm less visible and threatening to established firms in that niche. The failure of established firms to recognize the entrant as a threat can allow the entrant to build a viable position before being noticed by larger competitors. In addition, by limiting the scope of entry, the amount of investment put at risk is reduced and the firm avoids risking bigger losses involved in full-blown introductions, in case demand for the product fails to materialize. By proceeding with slow and deliberate steps, the firm is given the time to study the market and competition carefully, correct any initial errors, and fine tune its marketing strategy at a very low cost. A full-blown entry, on the other hand, could cause enormous losses if errors were discovered after the entry had occurred.

The requirements for success of entrepreneurial judo are essentially the same as those of the niche marketing strategy. Basically, the small firm needs to find a, preferably, underserved or unserved niche and create a product for that niche that competitors will find difficult to match. The ideal niche is actually one that incumbents find hard to serve adequately due to lack of resources, small market potential, or poor fit with their skills and capabilities. Consequently, no incumbents seem interested in meeting the needs of the niche and competitors are reluctant to counterattack. Also, it is important that customers in the niche are willing to often pay a premium for products that meet their needs better than existing competitors. Once the niche has been identified and entry has occurred the entrant needs to focus its efforts on that niche. Firms using this strategy should be prepared to abandon the niche if they are attacked by major competitors.

One of the risks involved in entrepreneurial judo is that, given the limited scope of operations and resources invested in the business, the entrant is an easy target should incumbents decide to retaliate. Retaliation can take the form of a frontal attack intended to crush the upstart; introducing a fighting brand to stop the progress of the challenger; or cross parry by attacking the entrant in one of its core markets, sending him a strong signal that it will suffer big losses if it continues challenging the incumbent firms. Small entrants should be on the lookout to detect any such moves by their larger competitors and take proper action.

2.3 Blue Ocean Strategy

Sun Tzu, the famous Chinese military strategist, wrote more than 2,500 years ago, “Those skilled in war subdue the enemy’s army without battle” (Sun Tzu 1980). Applied to business, Sun Tzu’s dictum suggests avoiding direct confrontation with rivals, making competitors irrelevant by serving markets that are not currently ignored or competitors.

Blue ocean strategy is the practice of identifying and targeting uncontested markets, that is, markets in which competitors are not present (Kim & Mauborgne 2016). In a sense, this strategy seeks to avoid head-on confrontation with powerful entrenched rivals in the current market that often leads to aggressive price-cutting, advertising wars, and other costly actions. Industries continually evolve as new markets are created, new technologies emerge, and new competitors emerge. Also, new industries are created all the time through blue ocean strategies, such as biotechnology, discount retailing, low cost airlines, laptops, and smartphones.

The main objective of blue ocean strategy is to bypass competitors and be the first to move into new geographical markets or create new markets by developing new products with different attributes, features or performance characteristics. Also to develop radically new technologies that leapfrog the competition and make existing products obsolete (Kim & Mauborgne 2016). Apple, for example, by-passed other computer manufacturers and introduced the wildly successful iPad tablet. Blue ocean strategies also include diversifying into unrelated products, entering newly created markets, and avoiding current competitors altogether.

In addition to being used by small firms, blue ocean strategies are also used by large firms that don’t find it profitable to introduce new products in the existing market due to high competitive intensity. For example, 3M is a company that uses a blue ocean strategy by continuously looking for new product ideas, and exiting from existing markets when entry of competitors results in crowded competitive conditions. 3M claims that 30 percent of its

sales is derived from products that didn't exist four years ago. This strategy has made 3M a highly diversified company with many new products including telecommunications equipment and refrigeration supplies.

The core concept of blue ocean strategy is that the best way win in the marketplace is to avoid competing with each other. Blue ocean strategy asserts that you can beat the competition by not competing directly with them but creating new uncontested market space. Red oceans represent all current industries, which is the known market space. A blue ocean is unknown market space in markets not in existence while red ocean industries have defined boundaries with given rules of competition which are widely accepted by current rivals.

The blue ocean strategy looks at the industry boundaries as malleable and takes for granted that they can be changed by industry participants. Instead of offering a better solution to an existing problem, it seeks to break the boundaries of the current industry and offer an innovative solution that appeals to existing customers and noncustomers. The new offering combines the best of the old offering and the alternative offering, as it strives to create greater and more innovative value compared with existing offerings.

Blue ocean strategies have been shown to be more profitable than red ocean strategies (Kim & Mauborgne 2016). Data show that in most industries, products and services are becoming more similar, and many customers buy on the basis of price. Profitability goes down as products become commodities and competition intensifies. Blue ocean strategies allow companies to break away from the red ocean type of industry and avoid the commodity trap and highly intense competition. As a result, companies that have created new industries based on blue ocean strategy typically create new profitable opportunities.

As discussed earlier, blue ocean strategies do not target the competition, but strive to make competition irrelevant by creating a new value proposition that opens new and unserved market space. It helps create value innovation which means creating real value for consumers through practical innovation that develops products that meet real market needs. Furthermore, the creation of new products or services through value innovation helps create blue oceans by simultaneously pursuing low cost and differentiation, something that is not easy to achieve with red ocean strategies.

Through value innovation, blue ocean strategy aims to drive costs down by eliminating expensive cost drivers and adding new features that improve the value of the offering. Value innovation is a strategy involving the entire system of a company's activities (Porter 2008). Value innovation is an integral approach of the whole system of activities designed to create a leap in value for customers and the organization. It aligns the whole system of organizational activities in the pursuit of value innovation and low cost and differentiation.

But where do you find uncontested markets? Uncontested markets exist in most markets, although it is harder to find in mature markets. The economy continuously creates new opportunities. Changes in technology and consumer tastes generate new market opportunities for entrepreneurial firms. Social and cultural trends also contribute to the pool of new opportunities. The changing demographics of a population help create new markets. For example, the graying of the population in North America and European countries has contributed to opportunities in the health care, and travel and leisure markets. Or, the growing concern for a healthy lifestyle has led to opportunities in the vitamin and herbal supplement markets.

But firms differ in their ability to identify market opportunities. Some are incapable of responding to environmental opportunities and others are sluggish. Managers need to develop the skills needed to spot unmet market needs and pursue them vigorously. Lack of such skills makes a firm vulnerable to bypass attacks by nimble competitors who can use these markets as beachheads to broaden their attacks on the market leaders.

Uncontested markets also exist because existing competitors view certain markets as too small and uneconomical to serve, they lack the technological knowhow to compete effectively, or they earn more profits in other markets. Wal-Mart found undefended territory in small U.S. towns in the early 60s. All the large retailers at that time were concentrated in the large cities. Although purchasing power was much larger in big cities, the level of competition was equally high, leading to what marketers call "majority fallacy." There was some competition in small towns, but by avoiding confrontation with large retailers and serving areas ignored by market leaders, Wal-Mart prevailed with a combination of innovative merchandise, supply chain methods, and low prices. By avoiding competition with large retailers, Wal-Mart built strength to the point that it could prevail in direct confrontation with these retailers when it subsequently expanded into large cities. By focusing on the needs of the discount segment in small towns, Walmart developed expertise in marketing, distribution, purchasing, and management. As the company was growing in size, economies of scale and scope kicked in driving unit costs even lower and raising profitability making Walmart even more powerful.

2.4 Underdog Strategy

An underdog strategy involves a small and, usually, young firm taking on a much larger competitor. It is, in many respects, similar to the classic battle between David and Goliath (Friedman 2013). It is employed by an upstart company that doesn't hesitate to get into a fight with much bigger opponents in order to break their monopoly and offer the market better products, lower prices, or both.

A study conducted by Paharia, Jill and Anat (2014) found that customer support for smaller brands increases when they are threatened by large dominant brands. Such support is not present when they compete against brands of similar size or when customers do not consider them close competitors with the larger brands. Paharia, Jill and Anat (2014) empiriccally show that creating awareness about a large competitor's size and proximity can help smaller brands. Customer support for underdogs is reflected in more purchases, higher purchase intention, and more favorable online reviews.

Research shows that people prefer to associate themselves with winners rather than losers suggesting that consumers prefer large brands since they are more likely to prevail in the marketplace (Cialdini & Richardon 1980). But the study conducted by Paharia, Jill and Anat (2014) shows that consumers relate to brands as part of a market competitive system, not in isolation. Consumers evaluate brands not only on the basis of the dyadic interaction between them and the brands, but also on the competitive relationships in which the particular brand is involved. Small brands are perceived as underdogs only when they face a threat from a powerful competitor. Without the presence of a larger competitor, a small coffee shop, for example, may be chosen on purely economic criteria such as quality and price. On the contrary, if a large competitor is located nearby, the smaller coffee shop might be evaluated within the broader competitive interplay, not only on the basis of brand attributes.

Research in the context of interpersonal relationships has documented that people take pleasure in the misfortune of others (Heath & Potter 2004). A large competitor may be seen as undeserving its market position and they may punish it, while enjoy them as they fail and take pleasure as they contribute to its destruction. Therefore, in addition to supporting smaller brands, consumers may also take pleasure by punishing large brands for wielding too much power. This is related to purchase activism, which is a psychological mechanism that mediates the purchasing process. It implies that the brand choices may be influenced by people's motivation to explain their views and make an impact in the marketplace by purchasing certain brands and rejecting others (Sandikci and Ekici 2009). Research shows that consumer activism is becoming common, and consumers are willing to purchase products and services that reflect ideas that are important to them (Tan 2007).

A small firm can achieve the maximum effect of the underdog effect by employing an underdog biography (Paharia et al 2011). People have always been inspired by underdog stories. Underdogs exist in many walks of life such as sports, politics, religion, military and movies. Marketers can use underdog narratives to create a positive image for their brands. An effective way to achieve favorable impressions is through a technique called brand biography which is an unfolding story that covers the brands origin and evolution over time.

Companies who plan the underdog biography emphasize the owner's determination to succeed against odds and the limited resources to achieve their goal. Most brand biographies emphasize the brand's humble beginnings and they typically keep the name of the original store location. An underdog narrative highlights, in addition to the company's humble beginnings, desperate and noble struggles against powerful competitors and dreams and hopes of the founder. Companies such as HP, Dell, Apple and Google emphasize how they began as garage operations. Among consumers, these who feel like underdogs are more likely to favor underdog brands because they identify with their struggle to survive, unlike consumers who do not consider themselves to be underdogs (Paharia et al. 2011).

2.5 Gaining Organizational Legitimacy

The first few years are difficult for a new firm because of the lack of legitimacy and reputation. As a result, new ventures suffer from lack of legitimacy in the eyes of important stakeholders such as stock market analysts, venture capitalists, and customers. The lack of legitimacy contributes to what is called liability of newness for such firms. Lack of legitimacy is a serious problem for a business because it prevents it from achieving its potential, and until the firm overcomes it, it will suffer from lack of resource acquisition, low customer acceptance, and growth (Rao, Chandy & Prabhu 2008).

Small firms and new ventures, because of the problem of liability of newness, have a much higher risk of failure than established firms. The liability of newness, coupled with the startup's lack of operating track record, makes it difficult for it to gain customers and acquire the required resources to succeed in business. This is one of the most important reasons why the survival rate of new ventures is low. Some scholars also argue that the success of a new product also depends, to a large extent, on the legitimacy of the organization (Rao, Chandy & Prabhu 2008). A recent study, found that only 36% of new ventures survive beyond four years. The survival rate drops to 21.9% after five years (Song, Podoynitsyna, Van Der Bij & Halman 2008).

It is possible for small firms and new ventures to overcome the liability of newness by taking actions that provide them with legitimacy in the eyes of stakeholders and customers. By engaging in such actions, new ventures increase stakeholder confidence and help to introduce their products successfully. Research in legitimacy theory suggests that observable legitimacy characteristics act as signals and are used by customers and other constituents to enhance confidence in the new product or business. Legitimacy can be obtained in several ways as explained below (Rao, Chandy & Prabhu 2008).

Competence of the management team - Legitimacy can be shown by a qualified founder, top management team, or founding team. Top management's legitimacy depends on the education, age, prior industry experience, and serves as a signal to potential customers of the firm capability and product quality. A firm has higher legitimacy if the founding team has a lot of industry and startup experience (Deeds, Mang & Frandsen 2004). Therefore, a founding team with a lot of industry experience will enhance the firm's legitimacy and it will help it appeal to stakeholders and early customers, increasing the chances of it becoming more accepted to later customers.

Scientific knowledge - New ventures need to convey to stakeholders that they have the knowledge and can work with the latest scientific developments in their field (Rao, Chandy & Prabhu 2008). New ventures can accomplish this objective by recruiting academics and scientists whose presence provides the firm with the technical credibility suggesting that the firm has the ability to develop new products, access to knowledge that the new venture does not possess and it can compete in its industry successfully. Hiring well-known scientists to serve on corporate boards is often used as a means of achieving scientific legitimacy.

Member of a cluster - The role of "clusters" in the success of new ventures has been recently recognized. New ventures can gain legitimacy by locating in areas with large numbers of related firms (Pouder & St. John 1996). These clusters and the presence of related firms can help a new venture because their presence in the cluster indicates to stakeholders that they have access to skilled labor and components and parts (Porter 2008).

Strategic alliances - Firms may gain external legitimacy through association with established and successful external entities (Higgins & Gulati 2006; Rao, Qu & Ruecken 1999), such as forming an alliance with an established firm in a related industry (Gans & Stern 2003). This enables the new venture to gain immediate access to the legitimacy of the established partner.

But there are certain risks and costs associated with alliances. One of the risks of alliances for a smaller firm is the potential loss of decision making, control, profits and flexibility for the new venture (Das & Teng 2000). Also the new venture may receive lower rewards from the new product's introduction as a result of its collaboration with the larger partner who due to its greater bargaining power will demand a disproportionate share of the profits (Gulati 1998).

Leverage early customers - Many new venture managers rely on early customers to communicate the value of the product and overcome the liability of newness (Wang, Song & Zhao 2014). The benefit of obtaining early customers is that it can send a powerful message to the rest of the market and testify about the quality of the startup's offering.

Therefore, focusing on early customers should be a key aspect of the new venture's marketing strategy.

3. Conclusion

This paper has discussed several strategies that small firms and new ventures can use to compete effectively against large competitors. It discusses how niche strategy, entrepreneurial judo, blue ocean strategy, underdog strategy, and gaining organizational legitimacy could be used by small firms and new ventures in their ongoing competitive battle with large firms to achieve market success. These strategies have been selected after an exhaustive search of the business strategy literature with the objective to identify strategies that can be used by small firms and new ventures to overcome their small size disadvantages and market their business successfully. This paper is unique in this respect, as it outlines how small business and new ventures can use each strategy to their advantage. This approach makes a significant contribution to the literature of small firms and new ventures, as it provides these firms with practical and evidence-based theoretically sound strategies they can use to better market their products and earn above average profits and market share. In this regards, this paper makes a unique contribution to the literature of small business and new ventures that is missing in the extant literature.

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