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# Strategic Principles for Low Share Firms

Peter Yannopoulos*

*This paper discusses a number of strategic principles that low share firms may use to overcome the advantages of large firms and compete successfully against them. These principles include: strategic interdependence and interaction, strategy as the search for competitive advantage, the element of surprise, creating mixed motives for competitors, concentration of force, and the path of least resistance.*

**Field of Research:** Strategic principles, low share firms, low share firm strategy

## 1. Introduction

Research in small firm strategy has received a great deal of attention in recent years (Bhide 2000; Ebben & Johnson 2005). Advancing our understanding of strategy for low share firms is essential because these firms play an important role in our economy (Baumol, Litan & Schramm 2007). Furthermore, academic research has addressed a number of questions regarding strategy in small enterprises. One of the basic conclusions of this research is that strategy has a strong influence on firm performance and that the strategy function differs in firms of different sizes (Leitner & Guldenberg 2010; Porter 1980; Woo & Cooper 1982).

One of the major challenges facing small business managers is how to compete effectively against large competitors. It is well known that large firms are often associated with certain large-size advantages. These advantages include lower costs due to economies of scale and scope, experience curve effects, and greater market power in terms of purchasing power. Large firms are widely visible, recognized, and admired by suppliers, customers, investors, and distributors. Suppliers usually offer them better contracts and investors are more willing to invest their money in a large company. Distributors are more than happy to carry products of large companies. Customers often prefer to do business with market leaders as they equate success with superior quality and perceive large companies as most successful (Ebben & Johnson 2005). As a result of low share firm disadvantages due their small size, many analysts advise such businesses to build market share or reposition themselves so that they dominate some market segment. If neither alternative is feasible, then the business should be harvested or divested.

Despite their disadvantages, however, higher performance is possible for well-positioned and well managed low share businesses. Several studies find that a high market share is not always necessary to achieve high earnings, and businesses with low market share can be successful (Woo and Cooper 1981, 1982). According to Woo and Cooper (1981, 1982) the strategy of a low share business must be tailored to the

*Peter Yannopoulos, Faculty of Business, Brock University, Canada, email: pyannopoulos@brocku.ca

requirements of the market and its capabilities. Successful small firms do not copy the strategies of high share firms but compete in distinctive ways and offer superior value by offering higher quality products at prices lower than competitors. They limit their expenditures in areas such as R&D, product line breadth, and marketing expenditures in order to achieve high performance despite lower sales volume. They are engaged in careful cost control and avoid the adoption of aggressive postures which parallel the competitor strategies of effective high share businesses. Ineffective low share firms, on the other hand, tend to imitate the strategies of effective high share businesses by engaging in intensive marketing posture and high levels of vertical integration. For low share businesses their scale of operations is not large enough to support all these activities resulting in their resources been spread too thin (Woo & Cooper, 1981, 1982).

Studies of small firms such as Ebben and Johnson (2005) found that small firms can be successful if they pursue either efficiency or flexibility strategies to achieve optimum performance, while small firms that adopt both efficiency and flexibility strategies underperform their rivals. Leitner and Guldenberg (2010) also found that SMEs that persistently follow a cost efficiency or differentiation strategy performed equally well. However, they found that small firms that pursue a combination of cost efficiency and differentiation perform equally well or better than small firms that pursue pure strategies.

Small firms often survive by exploiting opportunities created by large firms, such as offering lower price or generic products in markets dominated by large firms through heavily branded products. They exploit the typical structure of a market which consists of a small number of large firms that operate at or beyond the minimum efficient scale - obtaining the benefits of economies of scale - and a large number of small firms operating below the minimum efficient scale. Large firms tend to determine the nature of competition in a market while the smaller firms survive by entering niches that the larger firms are not willing to enter and, in general, doing things that large firms are not doing.

This paper presents several strategic principles that smaller firms can employ to compete successfully with their larger competitors. Many of these principles have been discussed elsewhere in a more general context. The contribution of this paper is to examine these strategic principles in the context of low share businesses, show how they can be effectively utilized by small firms, enhancing, thus, our understanding of the dynamics of competition among small and large firms.

## 2. Strategic Principles

In the following section several strategic principles are discussed including the concept of strategic interdependence and interaction, the search for competitive advantage, the element of surprise, the creation of mixed motives for competitors, concentration of force, and the path of least resistance. We also include a discussion of how small firms can use these strategic principles to overcome their small-size disadvantages and successfully challenge their larger rivals.

### 2.1 Strategic Interdependence and Interaction

Relationships among competing firms are frequently 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. One of the problems for marketing decision makers is that when they make a move to obtain an advantageous position, their rivals often respond quickly with a countermove of their own. As a result, the countermoves often negate the impact of the initial move and the firm making the first move could be worse off in the end. For example, the effectiveness of a price cut is determined by the prices set by its competitors. If the price cut is matched by competitors, it would most likely result in a price war that could negatively impact all the firms involved.

Because of this interdependence and interaction, firms tend to succeed at the expense of their competitors. Even marketing actions that, on the surface, do not appear aimed at competitors have a competitive element in them. Every action taken by management aims at the competition; some actions may be more direct than others, but every action has its own degree of competitiveness. When a firm hires a better production manager than its competitors, for instance, this manager may help the firm become more efficient in its production process, thereby giving it a competitive advantage.

Therefore, whatever a firm's strategic or tactical actions, it must act after it has anticipated its rivals' strategies. Marketers need to anticipate how their rivals going to react in response to their actions. For example, if a firm cuts its price, how will its competitors react? Will they also cut their price? If competitors cut their prices, what will happen to its sales and profitability? American Airlines, for example, failed to anticipate the other airlines' reaction to its introduction of a low price fare structure called value pricing. The overall price decrease was perceived as a threatening price cut by other major airlines and led to a widespread price war. Also if a firm increases its advertising budget, will its competitors also increase their advertising budget? If they increase their advertising budget, what will happen to its sales and profitability? Finally, if a firm enters a market niche how will the market leaders respond? Will they feel threatened and enter the niche, or sit on the sidelines?

Therefore, firms competing in the same industry are mutually dependent, as their competitive actions have an impact on their competitors, who often respond to threatening moves with forceful retaliation. The probability and extend of retaliation depends on a variety of factors such as the extent to which a firm perceives competitors' moves as a threat to its market position and profitability. If the challenge comes from a small competitor it will probably not be noticed. If, however, it comes from a large, well-known competitor, the move will probably elicit a retaliatory response. The amount of resources, skills and capabilities at the disposal of the established competitors will also be a factor. The more powerful the firm is, the more forceful its response is likely to be (Karakaya & Yannopoulos 2011).

The probability of response also depends on the incumbent's willingness to respond, which is, in turn, determined by its current strategy, image, profit margins, capacity utilization, and binding contracts with customers. A firm with a premium image will be reluctant to respond to a smaller firm that engages in price-cutting for fear of tarnishing its image and reputation as a premium brand. If a small firm cuts its price, a much larger firm may be reluctant to follow suit because it stands to lose disproportionately more than the smaller firm due to its much larger size, as it will lose margins on many more product units than the smaller firm. A firm with full capacity utilization or binding contracts may also be reluctant to follow suit with a price reduction because its sales will probably not be affected, at least in the short-run.

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. It has been said that "a business has to find a safe route through the competitive environment to secure profits. This route is vulnerable to spoiling tactics by the other players and to whistle blowing by the owners of capital" (Burke, Genn-Bosh & Haines 1991).

Low share firms should avoid entering segments occupied by larger firms, or segments in which large firms may become interested. Firms already in the same market segment, feeling threatened by an entrant, tend to defend their position by going on the counter-attack, thus neutralizing the new entrant before it becomes a serious threat in this market. Existing competitors can attack newcomers by embracing and improving the intruder's technology or product, attacking the upstart's credibility as a reliable source of supply or its reputation, repositioning the entrant as offering an inappropriate solution, or even purchasing them.

These were some of the tactics used by Microsoft in fighting the attack by Borland Delphi, a rapid development visual computer language, which was by far a superior alternative to Microsoft's Visual Basic language at the time Delphi was introduced in 1995. When Delphi was introduced, many people predicted the demise of Microsoft Visual Basic, which already had a stranglehold on the market. Although the clear superiority of the Delphi programming environment encouraged a large number of programmers, including some who were dissatisfied with Visual Basic, to switch to Borland Delphi, this prediction never materialized. By sensing the threat coming from the challenger, Microsoft went on the counter-attack by hiring away from Borland Delphi some of its best programmers and spending large resources on upgrading and improving Visual Basic, including providing a faster compiler that compiles a program into native code, neutralizing one of Delphi's advantages. Visual Basic not only survived, it increased its stranglehold on the market by forcing Borland Delphi into also-ran status despite the latter's superior advantages.

Sometimes the counter-attack is not broadly based, but takes place in only one segment in which the defending company participates. The following example illustrates how this limited counter-attack can be implemented. Holland Sweetener Company, a joint venture between a Japanese and a Dutch company, was formed in 1986 to market its own version of aspartame, a generic version of Nutrasweet's original aspartame. Monsanto, the owner of NutraSweet, in response to HSC's entry, dropped its price from

$70 to $22-$30 per pound. At that price, HSC was selling at a loss while NutraSweet saw its revenues cut drastically. Although it appeared an overreaction to HSC's entry, it was a smart strategic move. Nutrasweet's move was only limited to the European market, a small part of the total world market. This way it protected its much larger market in the U.S. By attacking HSC in a small market, NutraSweet sent a signal to rivals not to enter its other large market. Nutrasweet's move forced HSC to delay plans to expand and it never became a factor in the U.S., even after the aspartame patent expired.

### 2.2 Strategy as a Search for Competitive Advantage

In order for a firm to successfully compete in the chosen segment or niche, it needs to possess or develop the skills and capabilities required to defend the segment or niche and successfully pursue its strategy of satisfying the needs of the segment better than its competitors. A company needs to match its skills and capabilities with market and competitive requirements. According to business strategy expert John Kay (1995) "you need to identify your distinctive capabilities, select the markets or market segments best suited to these strengths, and develop competitive strategies to exploit your capabilities." Kay concludes, based on an analysis of the causes of failure of a large number of firms that, "the most common causes of failure are lack of sufficient skills and capabilities for the firm's objectives and aspirations."

Strategy is essentially a search for, and exploitation of, relative advantage. Everything a business does should be aimed at obtaining a relative advantage over its competitors. An analogous military doctrine is to concentrate strength against weakness. According to Sun Tzu (1971) the art of strategy is to exploit your relative advantages over your opponents. Sun Tzu (1971) wrote that "one mark of a great soldier is that he fights on his own terms or fights not at all" and he encouraged fighters to "engage in battle only when odds are overwhelmingly in your favor." Clausewitz (1968) also believed that identifying one's own relative advantages and disadvantages, as well as those of the opponent, is key to success in wars.

The relative advantage dogma applies equally well in business. Challengers should not enter a market that is well defended by existing rivals. Even large companies such as RCA and GE, who attempted to attack IBM in its mainframe market, failed miserably. Successful frontal attacks, pitting a challenger's resources against an incumbent's strengths, require overwhelming resources such as lower costs, superior technology, quality, financial resources, productive capacity, salesforce size, and higher advertising budgets to succeed.

The concept of strategic asymmetry developed in the field of military warfare is a useful analogy. Military writers define strategic asymmetry as the use of some difference to gain advantage. According to Arreguin-Toft (2005) the nature of the strategic interaction among the rivals is a major determinant of the outcome of the conflict. When actors employ similar strategic approaches such as direct-direct or indirect-indirect then relative resources explain the outcome of the conflict. Strong 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, when a smaller firm faces a firm with much larger resources, a conventional frontal attack is not advised and an indirect attack is recommended.

Low share firms should only engage in a fight with its competitors only if it is in a position to fight from a position of strength, not of weakness. Small firms that lack superior resources could successfully challenge large firms by using indirect attacks, such as entering underserved, neglected or undefended segments; flanking rivals and concentrating all of their resources on the rival's weakest point; and entering in an unexpected manner. The competitor's weakest point is the critical point of attack, what Clausevitz calls "the enemy's center of gravity" (Clausevitz 1968). Weak points take the form of high production costs, obsolete or lower quality products, inferior distribution systems or narrow product lines.

### 2.3 The Element of Surprise

Strategies work best when accompanied by an element of surprise. Surprise is vital in military warfare. Sun Tzu (1971) wrote, "All warfare is based on deception." Deception is the method by which an opponent concentrates his forces at the decisive point, while the opponent concentrates his forces in the wrong place, thus weakening his forces at the decisive point of the battlefield. Deception is an integral element of strategy and is used to achieve surprise. In the military, an opponent is surprised when his enemy's troops are concentrated where he least expects them. Surprise, in turn, can be avoided with competitive intelligence.

One of the most accepted doctrines of military strategy is that an invading army should take the path of least resistance. Smaller competitors can follow this doctrine and try to attack their larger competitors in areas they are least capable of defending. Studies show that SMEs primarily follow a focus/niche strategy with differentiation being the most popular strategy used by SMEs (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). 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. Using this approach, the smaller firm finds a niche in geographical markets, segments in which the opponent is weak and, especially, markets 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.

Surprise is effective because it does not allow opponents to prepare defenses and leaves them exposed to unexpected attacks. Competitors should be attacked where, and when, they least expect it. Firms could also try to influence expectations and the line of least resistance. A small firm could make its rivals underestimate its capabilities, skills, resources, or industry knowledge especially when dealing with gullible, naïve, arrogant, or complacent competitors. Low share firms should not allow competitors to find out about their true future plans such as their new product development or market entry plans. They should develop new products secretly and not announce them until they are ready to hit the market. An exception often occurs when a company announces the development of a product well ahead of its introduction to preempt the entry of a rival's product and force the competitor to either cancel or alter their plans.

The strategy of surprise works especially well when directed at a point where the opponent least expects to be attacked because it would be costly to attack. For example, North American carmakers were producing large cars and most of their new product development and investment was made in the large car market. The rationale was that profit margins were much higher in the high-end segment while profit margins were much lower in the low-end of the market and return on investment was low. For this reason, North American automobile manufacturers had effectively abandoned the small car segment and were defending the more profitable high-end segments. If the much smaller Japanese car companies had attacked American car companies in the well defended large-size segment, there would be no element of surprise. To obtain the benefits of surprise they would have to attack where it was least expected. That point had to be the less profitable, less defended, and almost abandoned, small-car segment.

Therefore, the greater the difficulty of doing profitable business in a market the greater the element of surprise. This means that achieving surprise can be costly. Firms tend to view costly or technologically challenging strategies as the least likely. Luttwak called this phenomenon "the conscious use of paradox" (Luttwak 1987). Firms looking for ways to apply the element of surprise should look at making products or entering markets that established competitors consider very costly, unprofitable, cannibalizing their existing products, or technologically challenging or impossible, and find ways to overcome these challenges.

### 2.4 Creation of Mixed Motives for Competitors

Creating a situation where competitors face conflicting goals can be an effective strategy for successfully challenging rivals. Creation of mixed motives for competitors can help cause difficulty to larger rivals by creating a situation that makes it very difficult for them to retaliate effectively (Porter 1980). Sometimes a company might be able to retaliate effectively to a rival's moves, but it could hurt the company's broader position.

Key to the principle of creating mixed motives for competitors is that very often a larger firm avoids attacking a challenger for a variety of reasons. First, by attacking a smaller rival it may help legitimize it as a viable choice in the eyes of consumers. Attacking a new competitor is sometimes avoided in order not to dignify the entrant with a response. For example, Coca-Cola did not respond to Snapple's entry into the fruit-based noncarbonated drink market for a long time, in order to avoid suggesting that the category existed and that soft drinks in the category were in the same category as Coca-Cola products. Coca-Cola's objective was to ignore the fruit-based noncarbonated category and avoid using any advertising that would even hint that the category existed. Coca-Cola later changed this strategy and introduced Fruitopia when Snapple's sales started to grow at the expense of Coca-Cola's brands.

Large competitors often feel constrained in their ability to react to the attack for fear of antitrust prosecution, or for fear that a low price may damage their brand's image. An incumbent may also be reluctant to reduce its price or increase advertising and promotion spending because of return on investment or profit expectations by shareholders or stock market analysts. Incumbents are also usually reluctant to retaliate if they operate at full capacity. Many large companies, in the pursuit of greater size, encounter problems with overly aggressive expansion such as high debt, poor liquidity, or poor service, which make them weaker and unable to respond when threatened by a smaller challenger. Other firms face difficulties as a result of increasing bureaucracy resulting from high growth, which in turn limits their ability to quickly adapt to environmental change.

This principle is especially effective for small or newly entering firms that have very little to lose by embarking on a strategy that creates problems for existing competitors. For example, the Japanese carmakers' attack of U.S. carmakers in the small car segment was effective because the latter were very reluctant to invest due to the lower margins and cannibalization. Similarly, Canon's entry in the small-business market was equally effective because Xerox didn't think that such a segment existed and this target segment was considered unimportant for investment. Competitors may also be reluctant to retaliate by lowering their price for fear of tarnishing their upscale image, because they operate at full capacity, or for fear of experiencing huge profit reductions if they respond to a price-cutting challenger with a price reduction due to their much bigger market shares (Gelman & Salop 1983; Yoffie & Kwak 2001).

### 2.5 Concentration of Force

Many firms have been able to overcome their numerical inferiority by using the principle of concentration of force. This principle allows even small companies to take on much larger competitors by concentrating on one particular segment of the market which they dominate while their much larger competitors are spreading themselves thinly across many segments or markets.

Targeting a small part of the opponent's forces allows an attacker with a smaller force to overwhelm the opponent and defeat it easily. This is the principle of the concentration of forces at the decisive point. The famous military philosopher Clausewitz wrote: "There is no higher and simpler law of strategy than that of keeping one's forces concentrated...to be very strong; first in general, then at the decisive point." (Clausewitz 1968). Sun Tzu (1971) made a similar observation when he wrote, "If I am able to determine the enemy's disposition while at the same time I conceal my own, then I can concentrate and he must divide. If I concentrate while he divides, I can use my entire strength to attack a fraction of his. There, I will be numerically superior. Then if I am able to use many to strike a few, at the selected point, those I deal with will be in dire straits."

Marketers need, therefore, to search for the quickest, most decisive victory by attacking with absolute or relative numerical superiority at the decisive point of contact. Although it is easier to win the marketing war by having absolute superiority in resources, what both Sun Tzu 1971) and Clausevitz (1068) advocate is that what matters most is not an absolute superiority, but superiority at the decisive point, which is the point of engagement. This means that numerically smaller firms with capable leadership can beat much larger competitors by correctly employing the concept of concentration of forces at the decisive point. Successful application of this concept can enable a firm to achieve relative superiority at the decisive point. The point, then, is to maneuver into a position that enables you to engage a fraction of the opponent's forces with the bulk of your forces. On the contrary, anyone who "prepares everywhere…will be weak everywhere" (Sun Tzu 1971).

Depending exclusively on numerical superiority as a means of defeating an opponent is a risky proposition. According to Clausevitz (1968), "superior numbers, far from contributing everything, or even a substantial part, to victory, may actually be contributing very little, depending on the circumstances." It is well documented that smaller armies have been able to defeat superior opponents by attacking with concentrated forces at weak points, and by using deception, superior motivation, surprise, and superior military technology (Arreguin-Toft 2005).

Once the enemy is defeated, the attacker goes after another part of the opponent's forces with superior forces, which he defeats, and so on. Canon used this strategy when it invaded the British photocopy market, dominated at the time by Rand Xerox. Canon first concentrated on the Scottish market and did not attack the London market until it obtained a market share of 40% in the Scottish market.

### 2.6 The Path of Least Resistance

One of the most accepted doctrines of military strategy is that an invading army should take the path of least resistance. The principle of the path of least resistance calls for attacking a competitor in areas where they are weak and difficult to defend (Spulber 1998). The competitor's weakest point is the critical point of attack, what Clausewitz (1968) calls "the enemy's center of gravity." Weak points take the form of high production costs, obsolete or lower quality products, poor service, inferior distribution systems, or narrow product lines. Finding the critical point of attack is not easy. However, concentrating all of their resources and attacking competitors at their weakest point may enable even small firms - seeking expansion but lacking superior resources - to successfully challenge larger firms.

Smaller competitors should follow this doctrine and try to attack their larger competitors in areas in which they are least capable of defending. Engaging in a flank attack is a strategy that is usually 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 flank attack takes place in geographical markets or segments in which the opponent is weak and especially markets whose needs are under-served or not served at all. As such, a flank attack is an indirect type of attack and it is commonly used by small firms against much larger opponents. Flank attacks can also be used by large firms when they enter markets dominated by other firms.

In essence, a flank attack involves attacking competitor weaknesses with strength. Some segments are not served well by major competitors. These are segments that competitors either do not see them as important enough to warrant more attention, or are less profitable than other segments or because they think they are safe and are not entry targets by competitors. A firm could enter these segments with a superior and/or lower cost product. The point is to avoid confronting the competitor when you are weak, gradually building strength and eventually challenging your competitor directly. By avoiding devastating retaliation and pricing wars, the small entrant can focus on serving customers by improving the product or service and lowering his costs.

By finding an underserved niche and becoming successful in that niche, the firm can improve and upgrade its products, extend its product lines by introducing additional items and enter additional niches until it eventually is in a position to take on the much larger competitor head on. By using a successful flank attack a challenger is able to chip away at the market position of the market leaders without provoking a direct retaliation by them.

## 3. Conclusion

This paper has extensively discussed several strategic principles that small firms can use to compete against large competitors. These strategic principles include: interdependence and strategic interaction among firms, search for competitive advantage, the element of surprise, creating mixed motives for competitors, concentration of force, and the path of least resistance. This paper discusses how these strategic principles can be employed by small firms in their ongoing competitive interaction with large firms.

By employing such principles low share firms can obtain a significant leverage over much larger opponents and prevail over them despite their significant disadvantages. The only way for a low share firm to overcome its size disadvantage is to follow strategies and principles that allow it to overcome such disadvantages. This paper has described these principles and it is up to low share firms to adopt them and use them to their advantage.

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