Perishable goods and a boiled frog:

an analysis of a small business

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What happens to a small business when it is confronted with major shifts in the industrial base around it? How might its management respond to the resulting loss of customers and to changes in the local community?

New Zealand's entry into the international market free-for-all in the 1980s gave many businesses an opportunity to test themselves under such circumstances and the following study illustrates how one management responded. The "boiled frog" concept, a management metaphor coined by Handy (1991), provides a lens into the struggles of a small New Zealand retail food products firm and highlights risks and opportunities of which many may wish to be aware.

BOILED FROG METAPHOR

The boiled frog refers to a frog that, otherwise keen to save itself, fails to jump out of gradually heating water because it does not recognise the seriousness of the problem. It is a metaphor for business managers who fail to modify business strategy or practices in response to the growing and gradual risks rising around them. The boiled frog syndrome is consistent with the belief that management should avoid blind adherence to pre-ordained plans in the face of unexpected changes in the business environment (Mintzberg, 1987; Morris, 1988).

This is the study of a small business. At least 85 per cent of New Zealand businesses employ five or fewer full-time employees. The sector accounts for 42 per cent of all employees and contributes to 33 per cent of the country's economic output (Ministry of Commerce, 1999). In other words, the success of New Zealand small businesses contributes to the success of New Zealand's economy as a whole. Our focus on the Rural Fruit and Vegetable Mart (the Mart) targets this important segment of the New Zealand economy.

The small business caught in the boiled frog syndrome is often characterised as a long-established, "hard-working, introverted, family

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firm” (Richardson, Nwankwo and Richardson, 1994, p.10), whose owners fall into inflexible patterns of behaviour because they are so involved in day-to-day traditional activity.

In these businesses, crisis tends to “build up slowly while the existing management is busy looking after day-to-day business” (Dibben, 1991). There tends to be a management “blindness” to conditions that require new approaches (Richardson et al, 1994, p.12) and change is often resisted by tradition-bound managers.

Eventually, when the problems can no longer be ignored, small stop-gap measures may be taken. Eventually, the problems grow to leave a “strategic gap” which, when large enough, can only be countered with drastic measures, usually conducted under crisis conditions (Richardson et al, 1994, p.11).

Ultimately, the risk is that the business will fail because management does not respond aggressively to gradual changes brought about by the demands of a new environment (Johnson, 1988). We will be highlighting these features in our analysis of the Mart to illustrate how the boiled frog situation can occur.

We make no attempt to place judgement on whether discontinuities should or should not exist; they simply do so and the small business is left to cope with that which remains. Nor do we attempt to formulate a strategy for the Mart or to develop strategic options for its management, although we certainly encourage them to do so. Our focus is to obtain an understanding of the conditions and the actions that have brought the Mart to its present situation and to convey how that situation reflects the boiled frog syndrome.

THE CONTEXT

The Mart is a family-owned fruit and vegetable shop in a small New Zealand town that is characterised by its long dependence on the wood products industry and government subsidy.

New Zealand’s industrial, energy and transport infrastructure was constructed and supported by a generous post-war central government. This situation no longer exists and support for these industries is, in the past 15 years or so, only from private, profit-oriented sources (Bassett, 1998).

The wood products industry competes in an international and generally deregulated environment (Good Time for Pulp and Paper Growth, 1995, May), but the same quest for efficiency has led to massive reductions in the workforce. Those still employed, according to our shopkeepers, tend to live and/or shop further afield. Not surprisingly, the Mart now caters to more elderly customers and others on income support.

The Mart has four staff, including the two partner-owners – in the business for more than 10 years – and two part-time employees. The managers purchased the business from a one-off settlement and they have no other personal investments. They characterise themselves as protective of their assets and naïve with respect to planning. The nearest local competitor is one major local supermarket and, for about a year, another fruit and vegetable shop, since closed.

While they do not undertake detailed financial analysis, their regular practice of scanning the profit, expense and sales figures from annual statements prepared by their accountant alerted them to a problem and inspired a request for an investigation.

The Mart’s management does not conduct formal market analysis as suggested by accepted practice (e.g. see Hogarth-Scott, Watson and Wilson, 1996), but there is a history of small-town familiarity between the owners and their customers. They have operated on the

TABLE 1

Delphi results

Issues raised	Round 1: Number who raised	Round 1: Consensus	Round 2: Number in agreement	Round 2: Consensus	Round 3: Number in agreement	Round 3: Consensus
Strengths						
Service reputation	10	Yes	10	Yes	10	Yes
Quality of produce	8	No	10	Yes	10	Yes
Competitive prices	8	No	10	Yes	10	Yes
Discounts	1	No	10	Yes	10	Yes
Free delivery	1	No	10	Yes	10	Yes
Good variety	3	No	10	Yes	10	Yes
Weaknesses						
No weaknesses	5	No	0	Yes	0	Yes
Lack of advertising	5	No	10	Yes	10	Yes
Resistance to change	*					
Opportunities						
Interest in convenience shopping:						
… opportunities for restocking	5	No	7	No	7	No
… one-stop-shop preferences	5	No	10	Yes	10	Yes
Untapped market	4	No	9	No	9	No
Threats						
Neighbourhood decline:						
… reduced foot traffic	8	No	9	No	9	No
… proximity to games shop	8	No	9	No	9	No
… need to relocate	4	No	9	No	9	No
Declining customer base	3	No	10	Yes	10	Yes
Declining customer buying power	3	No	10	Yes	10	Yes

A total of 10 participants. *Identified later to the analysis and not brought into the questionnaires.

assumption that their customers would raise any issues of concern with them directly.

RESEARCH METHODS

Interviews, questionnaires and a financial analysis provide us with an understanding of the Mart.

The Delphi Method facilitates discussion among 10 participants to the study. In a Delphi, the participants address, and re-address, a problem through repeated contacts with each other and with the researcher (Paliwoda, 1983). It is through this process that they have an opportunity to consider, develop and revise their views over time and hear the opinions and ideas of others. The aim of the classic Delphi is to reach an informed consensus – in this case, on the nature of the Mart's business environment and management.

Our 10 participants included the two partners, the two employees, two suppliers, two current customers and two potential customers from the local area. Four contacts were made with all participants, involving multiple questionnaires and interviews. All questionnaires and related correspondence were completed within eight weeks. At that point, no further convergence of opinion appeared likely.

All participants to the Delphi stayed throughout the study. A financial and ratio analysis (1995-1999) was also performed and we obtained access to two sets of benchmark data (Kristy, 1994; MRC, 1999) for comparison purposes.

The results are structured using a strategic analysis approach termed SWOT, which identifies the strengths and weaknesses of the internal workings of a business and the opportunities and threats posed by external factors (Ruocco and Proctor, 1994; Barney, 1995).

Finally, a post-fieldwork interview with the owners reveals the process by which they responded to (or failed to respond to) the situation and their views now.

RESULTS

The participants to the Delphi identified key issues and these are classified into one of the four SWOT categories. They, and the steps taken toward consensus on them, are revealed in **Table 1**.

The first survey (Round 1) generated 16 SWOT points and the views expressed appear to have been influential on the others in later

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rounds. For example, “Discounts”, “Free delivery” and “Good variety” went from 1, 1 and 3 participants respectively to 10, 10 and 10 in later rounds.

As well, all participants eventually adopted the view that weaknesses existed within the business, as indicated by the decline in the number of participants identifying “no weaknesses” to zero by the end of the study. Our impression is that participants held unformulated views before the study and were strongly influenced by the others. After Round 1, only one new point was added (“Resistance to change”) and, as illustrated in Table 1, there was a move toward consensus on all of the issues.

The opinion shifts that occurred over the course of the Delphi are important. They not only represent a refinement of thought, they also illustrate how the owners, who were of the original five who believed there were “no” weaknesses, conform, in this respect at least, to the boiled frog image of introverted managers.

STRENGTHS

“Strengths” of the Mart reflect the owners’ commitment to service and quality: customer service, quality and variety of produce, competitive prices and free delivery. The owners’ style of management also suggests that service and quality produce are important.

The owners said they have always had hands-on involvement. They put in long hours, at least one of the owners is on-site virtually every day, and together they manage the buying, delivery and storage of stock.

It is not surprising, therefore, that over the period of their management, they have, as they claim, developed a network of reliable farm suppliers, an extensive knowledge of produce and a knowledge of their customers’ interests.

The Mart’s traditional strengths thus appear to remain appealing to their remaining target market and, most importantly for illustrating the boiled frog situation, they again conform to our expectation of the hard-working family firm.

Profit and loss figures provide some indications of their dedication to the business. According to Kristy (1994) and MRC (1999), an acceptable gross profit margin ranges between 23-26 per cent, a pattern that has been generally maintained by the Mart **(Table 2)**.

In 1996, the gross profit margin dropped to

TABLE 2

Ratio analysis

	Benchmarks		1999	1998	1997	1996	1995
	(1)	(2)					
Gross profit	23%	25.5%	23.8%	20.8%	18.2%	21.2%	20%
Net profit	4%	6%	5.2%	5.8%	2.8%	3.2%	3.5%
Return on assets	14%	n/a	29.7%	40.1%	20.1%	22.2%	25.6%
Return on equity	30%	n/a	50%	100%	225%	56.3%	40%
Current ratio	2.2	n/a	1.33	1.08	1.00	1.08	1.17
Acid test ratio	70%	n/a	83%	77%	71%	77%	83%
Inventory turnover (days)		5.57	5.23	2.65	2.48	2.42	2.12

“Benchmark” refers to the figures provided by (1) Kristy (1994) or Troy (1987)* for similar businesses and (2) 1999 New Zealand data produced for fruit and vegetable stores (averages)

18.2 per cent, apparently due to price competition when the owners were pressured into a price war with another local business. This competitor closed down after a year and profits returned to the target rate at that point.

Apart from this decline, from which the shop appears to have recovered and prevailed, the gross profit margin in itself is not alarming. While these events illustrate the Mart's susceptibility to competition, it also illustrates the owners' perseverance in retaining a going concern.

The Mart has also maintained its solvency ratios which are in line with or which exceed industry standards. Short-term indicators — the current and the acid test ratios — have also remained at reasonable levels throughout the period under review.

This may well be some attestation to the owners' conscientious and conservative management, particularly in light of the difficulties they have endured from the steady loss in revenue. In any case, as long as the stock value has not declined dramatically, they appear to have enjoyed a solvent position.

While we view this as a strength of the organisation, the results may not be as clearly favourable as these numbers suggest.

WEAKNESSES

The only point of weakness on which the participants come to identify and ultimately agree is about advertising. The advertising budget has been reduced over time to zero in the past year. The consensus is that the business' lack of advertising lets the firm down and all, including the owners, have ultimately come to agree on this point. Management's actions in this regard beg the question of why this cost was cut back.

In response, the owners inform us that they "reduced advertising … to save money" and to avoid borrowing. They acknowledge that they are averse to risk and that they resist spending and borrowing to cover cash shortfalls.

After reviewing the results of this study, they themselves conclude that they "weren't seeing the big picture … that although these things cost money, they were also important factors in increasing their sales".

While we do not suggest that an advertising strategy would necessarily have an effect in this case, we do note that the very presence of this history of fiscal conservatism conforms to assumptions of the boiled frog. The ill-considered adoption of cost-cutting tactics in the face of falling sales and discontinuities, unintentionally limiting their options to expand their market, are typical of the sort of inertia-like response expected of the small-business manager caught within this syndrome.

The Mart's cost patterns indicate yet further weaknesses. Cost-cutting measures appeared to be introduced where such costs were controllable and they tended to suffer cost increases where they were less so. For example,

The owners acknowledge that they are averse to risk and that they resist spending and borrowing to cover cash shortfalls aging assets may have forced increases to repairs and maintenance costs which grew in 1998 and 1999 **(Table 3)**.

Rent, a less-controllable cost assuming the same location, seems high relative to benchmarks. Interest expenses became a significant factor in both 1999 and 1998. Other operating costs – such as the wrapping used for vegetables – behave as direct costs and may have declined only as a result of lower revenues.

Intentional cost-cutting is apparent in controllable areas such as salaries, advertising, security and office expenses. These cuts, particularly in salaries, may well account for the fact that the firm has remained in the black with a net profit above benchmark, despite declining sales. The Mart has little room to move now, however, and cost-cutting is a less-viable option for the future.

It also appears that the accounting methods used give the income statement a rosier glow than what can be anticipated for future years. For example, Goodwill, given the current situation, seems high and FIFO (expensing older, lower-cost stock layers) may benefit the income statement in the short term, but may show less-favourable results later on.

The equity balances illustrate how an infusion of capital was needed and was at times provided from owner investment and from reductions in owner drawings.

While the Mart is operating well above the benchmark equity ratio of 30 per cent (Table 2), this appearance may be deceiving, as it has come about partially due to the fact that the equity component of this ratio has been reduced each year from drawings.

In a related observation, drawings have

TABLE 3

Financial position and operations extracts 1995-1999

	Dollar values (000s)				
FINANCIAL POSITION	1999	1998	1997	1996	1995
ASSETS					
Cash and savings	5	5	5	5	5
Stock on hand	3	2	2	2	2
Plant and equipment	6	7	8	9	11
Motor vehicles	1	1	2	3	4
Goodwill	20	20	20	20	20
TOTAL ASSETS	35	35	37	39	42
TOTAL LIABILITIES	13	21	33	23	17
ENDING PARTNER EQUITY	22	14	4	16	25
CHANGE IN EQUITY					
Opening balance	14	4	16	25	29
Net profit	11	14	8	9	10
Partner drawings	16	10	29	25	24
Capital contributions	13	6	9	7	10
CLOSING EQUITY	22	14	4	16	25

	1999		1998		1997		1996		1995	
INCOME STATEMENT	$	%	$	%	$	%	$	%	$	%
Sales	196	100	247	100	257	100	276	100	307	100
Cost of sales (80%, 73%)	149	76	196	79	210	82	215	78	246	80
Gross profit	47	24	51	21	47	18	61	22	61	20
Wages expense (8.9%)	8	3	7	3	9	3.5	9	3.5	14	5
Repairs and equipment cost	4	3	2.5	1	1	.5	-	-	1	0
Rent expense (1.4%, 3.3%)	8	4	7	3	8	3	8	3	9	3
Interest expense (.5%, 1.5%)	7	4	7	3	.7	0	1	0	.7	0
Other	16.1	8	23.4	9	20.6	8	28	10.5	26.3	9
Total op. expenses (24%)	43.1	22	46.9	19	39.3	15	46	17	51	17
Net profit (.7%, 4.1%)	3.9	2	4.1	2	7.7	3	15	5	10	3

Benchmarks, where available, in brackets become increasingly close to owner capital contributions. The managers have informed us of their reluctance to borrow and this is reflected in the nature of their sources of finance.

Liabilities have declined as has owner capital. This puts the owners in a somewhat precarious personal position as they depend on the Mart for their own income.

The declining balances in, and ages of, Plant and Equipment and Motor Vehicles suggest that other aspects of the capital base have been allowed to erode **(Table 4)**.

TABLE 4

Major asset values at 1999 year-end

	Original cost $	Depreciated value
Plant and equipment		
Fixtures and fittings	5000	500
Cash registers	2000	240
Scales	3000	230
Computer	3000	400
Portable cooler	10,000	3000
Motor vehicles	10,000	900

Together, the financial analysis contributes new information to our understanding of the Mart, highlighting a declining revenue pattern and capital base, a declining source of capital (assuming that the owners continue to avoid borrowing options, if available) and a declining turnover with possible implications for lower-quality produce.

This adds to our understanding of the Mart's weaknesses and illustrates the gradual fiscal decline that would be typical of the situation encountered by a business caught in the gradually heating water of the boiled frog.

OPPORTUNITIES

The least consensus arose with respect to the nature of external opportunities for the business. It may be possible to gain insight into why this occurred in light of the owners' general resistance to change.

The opportunities emerging from the Delphi discourse tended to be raised in terms of strategic options, such as the suggestion to diversify. They are interpreted, however, in terms of how they reflect on the potential opportunities available to the Mart, given the demand for such changes.

Five participants raised, and eventually seven (not including the owners) upheld, the view that the Mart should stock a greater variety of products for "convenience shoppers" because, as expressed by one participant, customers simply have less time. In a separate discussion, all 10 respondents agreed that people prefer one-stop shops for convenience.

This view is not surprising in light of the changes that have occurred in this community; more residents commute greater distances to work, and there may be more time pressures on families generally.

The demand for convenience is an *opportunity* for a shop such as the Mart because it may be able to cater to convenience needs.

In contrast, however, the owners believe that it would be difficult to obtain a margin on these

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new products once the overhead costs were considered. The owners also have strong reservations recalling their own experiment in stocking bulk produce and health foods that led to a disappointingly lower turnover.

The combination of this experience and their concern over possible expansion costs suggest to them that this is not a viable option. Hence, this opportunity is one that was, perhaps wisely, not taken up.

One does wonder, however, if other stock alternatives – such as carrying basic dairy and news items for the convenience shopper or the high-volume stocking referred to earlier – might not entice more customers into the shop at little cost.

It was also pointed out that a marketing plan targeting only existing customers may overlook the important potential for growth within a similar, but untapped, group of residents. That is, they may not be reaching those who are elderly or who are, for other reasons, stay-at-home residents, new residents to the area or people unfamiliar with their shop.

The view of most of the participants would suggest that a revised marketing plan could play a powerful role in redefining the shop in a changing market and that the Mart's owners have reduced their options by cutting advertising, some of which could potentially reach this market.

The literature would appear to support the potential for these options. For example, and within this industry, reports on United Kingdom trends in fruit sales conclude that public awareness campaigns to increase fruit consumption have been effective in increasing revenues (Clarke and Moran, 1995).

A business dealing in basic products, such as fruit and vegetables, could also benefit from a narrowly defined, high-volume approach "by offering basic products at commodity prices from low-cost, edge-of-town superstores" (Thornhill, 1991).

In addition, there are opportunities through the internet and email for home shopping (Fernie, 1997) that could be attractive to the elderly customers in this market.

While we do not know the "best" strategy for the Mart, we do note that one bad experience led to a reluctance to consider other options. This is behaviour typical of the inertia found in the small business caught in the boiled frog.

THREATS

There is wide agreement about the nature of the three most prominent external threats and they reflect concerns with the neighbourhood, the customer base and customer buying power.

A general decline of the immediate neighbourhood accompanied the loss in high-paying industry jobs.

Location has thus become a concern in terms of both the immediate street location and the town itself. The current promenade location, a small shop area, is clearly in decline. Only half of the shops remain open along the promenade where the Mart is located. As a result, foot traffic has declined dramatically and it is felt that many of the customers who used to patronise the shop no longer do so as a result.

The owners are among those who originally recognised this problem, but again they have not taken the relatively radical action needed to change it.

Nine respondents were equally concerned with the *nature* of the adjacent businesses. In particular, it was pointed out that people, especially older citizens, are intimidated by the language and behaviour of the patrons of the

TABLE 5

Strengths, weaknesses, threats and opportunities

Strengths	Weaknesses	Opportunities	Threats
Service reputation Quality of produce Competitive prices Discounts Free delivery Good variety Profit maintained Solvency maintained	Declining revenue No advertising/marketing Declining capital base High rent Limited finance available from owner-investors Declining turnover (and older produce?) Resistance to change	Customer interest in convenience Untapped market	Neighbourhood decline Declining customer base Declining customer buying power

games parlour nearby. These patrons also use skateboards and leave bikes lying in the middle of the walkway, creating a physical hazard.

Clearly, the safety and inconvenience of the location constitutes a growing threat to the business, yet the shop owners have taken no action to counteract these threats.

Other threats appear to be beyond the direct control of the owners and relate to the discontinuities to which this business has been subjected.

All 10 respondents came to a view that competition from local and out-of-town supermarkets, especially for the growing number of commuters, would draw revenue away from the Mart. Addressing this threat would likely require a major commitment to change, such as shifting to another town or location, but these options have not been explored.

Finally, it was agreed by all respondents that the decline of buying power in the town could affect the Mart's ability to improve its revenue base. The declining size of the town's population would have an obvious effect and the changing patterns of its remaining residents, many more of whom are unemployed and/or are on the public benefit, would appear to do so as well.

Overall, therefore, these external factors constitute a major threat to the Mart's future viability and may call for more radical change than has been considered.

Together, the range of strengths and weaknesses revealed from the Delphi and financial analysis, and the opportunities and threats revealed lead to the points illustrated in **Table 5**.

ANALYSIS

The failure to identify and be ready for the endings and losses that change produces is the largest single problem that organisations in transition encounter (Bridges, 1991, p.5).

The Mart is revealed as a small business, contracting in size to stay afloat in a declining market. The owners' infusion of capital and time into the business does not obscure the fact that the business is at risk.

Revenues show a steady pattern of decline, fundamental costs have been slashed, the asset

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base has declined and inventory turnover has slowed. It is unclear if the shop will be able to support the owners' living much longer.

Customers, suppliers and other Delphi participants provide explanations in the form of declining neighbourhoods, a dangerous location, and growing demand for convenience shopping.

The owners could have analysed their situation and changed their direction accordingly. They could have formulated a response to the problems they were encountering and identified a series of strategic options to counteract the risks found, or they could have exited from the business and saved what capital remained. To date, they had done none of these things.

Instead, their actions were restricted to personal investment and business contraction. They persisted in long-established habits of introversion and fiscal conservatism at a time in which it may have been wise to consider other options.

While they are encountering adverse business conditions over which they have no control, the failure to plan or to act in accordance with any strategic direction appear to be contributing to a growing crisis. In these and other respects, the boiled frog syndrome is represented by:

- Obtaining minimal information about their business from outside sources and failing to conduct market analysis or formal planning.
- Applying stopgap measures, such as the reduction in employees' and owner drawings, to attempt to reverse the trends.
- A resistance to alternatives, such as modifying the nature of their stock or relocating.

For this business, a strategy that may have worked well in a company town no longer applies. Yet the changes from a declining population revenue base have come about slowly.

The risk is clear: the water is heating up. Will management act before it is too late?

CONCLUSION

While we would like to provide a "way out" for the management of the Mart, this is not our task. Our aim and hope is to help them and, hopefully, others in similar situations, *identify* the danger they are in so they will be inspired to take timely action.

The owners are strongly encouraged to take our analysis further. We are optimistic in this regard, as their final remarks were about their growing awareness of the importance of planning and of acting before it is too late.

More specifically, our study provides an illustration of a small New Zealand business caught up in the discontinuities leading to the boiled frog situation, and the risks of not responding to the resulting changes. It would

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seem to be *particularly* crucial for the very small business to identify such patterns, because the access to resources to shore up a business, or to compensate for mistakes, is so limited (Rodwell and Shadur, 1998).

There is reason to suggest that many small enterprises in New Zealand could be subjected to similar dilemmas given the predominance of small and medium enterprises (SMEs) in this country and given the high failure rate (up to 90 per cent) in the smallest of these firms (Ministry of Commerce, 1999).

Our analysis illustrates the importance of, in the first instance, recognising the boiled frog situation before the strategic gap yawns too widely. The Mart owners have done so. In working with us on this study, we find they have emerged from the experience with what appears to be new insight into the crucial significance of their situation.

They, and others caught in their situation, should also analyse their market carefully and incorporate planning into their management agenda.

Finally, as our case illustrates, successful managers must be willing to act in ways that may be unfamiliar to them. The knee-jerk reaction of business contraction is not necessarily the best option and it is certainly not the only one.

Breaking old patterns may be difficult, but inertia may be the greater danger. As is illustrated by the declining financial and customer base of the Mart, the leap must be taken before the water has come to the boil.

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KEY READINGS

Key readings on the subject of the boiled frog metaphor should start with Handy (1991). Richardson, Nwankwo and Richardson (1994) usefully apply the metaphor to small business. Statistical data from the Ministry of Commerce (1999), Kristy (1994) and the MRC (1999) were most helpful.

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