

***Steering Through Tough Times? Insights Into Strategic Change Processes Of Small Firms In the Context of Demographic Challenges***

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## ***Steering Through Tough Times? Insights Into Strategic Change Processes Of Small Firms In the Context of Demographic Challenges***

### ABSTRACT

*Market transformations induced by demographic change pose a challenge to the strategy-formation of small firms, because the effects of demographic change on firms are complex and partly non-predictable, and will only be slowly evolving over time. Hence, adaptation to change in business environments characterised by demographic challenges, such as population ageing and decline, can be considered as an entrepreneurial task, which requires both the monitoring of changes based upon information management, and flexibility and learning. By considering demographic change as a context of market crisis and turbulences, this article explores the strategic change processes of small firms in Germany. Conceptually, the paper is informed by various perspectives on the strategy-formation and strategic adaptation of small firms in dynamically changing environments. Empirically, qualitative case study analysis is presented in combination with descriptive data from a postal survey, covering firms in different German regions affected by demographic change. The article provides insights into the strategic responses of firms to demographic change particularly in the field of local sales markets. It finds that market leadership is the most important adaptive strategy along with market expansion, while gradual divestment is typically not chosen. If so, such partial market exit strategies are embedded in local business networking as an accompanying strategy. The study moreover emphasises the firms' approach to adaptive strategy-formation that is associated with foresight and information management, on the one hand, and learning and risk-taking, on the other. In doing so, it confirms the validity of the strategy-as-process perspective, which conceptualises strategic change in response to demographic change as a process that is marked by the awareness and perception of market changes, requires proactivity to respond to the changes and results in firm-specific patterns of strategic adaptation.*

**KEY WORDS**

Strategic change, Strategy-formation, Small firms, Demographic change, Adaptive strategies

**Introduction**

How do firms that face declining and changing markets because of demographic challenges cope with these major transformations in their business environments? Do firms build adaptive strategies to respond to these changes, and, if so, which strategies are actually applied? These questions increasingly gain in importance because demographic challenges, such as population ageing and decline, are gradually transforming the markets for firms across many European regions (European Commission, 2014; Willekens, 2014). The present article explores the impact of such demographic change on strategic change processes with firms by focusing on small enterprises and their strategy-formation for local markets. From a resource-based perspective (Barney, 1991), small firms encounter important resource limitations, compared to larger enterprises, which represent a barrier to their growth or competitive advantage. Demographic change puts an additional strain on their adaptive strategy-formation, which, as a stylised fact, faces some restrictions owing to both the emergent, implicit nature of their strategies, and their general lack of resources (Jones, 2004; Schindehutte & Morris, 2001). An alternative interpretation of market change, however, considers such environments as a context for opportunity-seeking individuals including key actors in small firms (see, for example, Soinen, Puumalainen, Sjögren, & Syrjä, 2012). Market transformations can induce small firms to turn into risk-taking, forward-looking entrepreneurs, based upon flexibility, learning and experimentation, and innovative strategies (Wolff, Pett, & Ring, 2015; Battisti, Deakins, & Perry, 2013).

The present paper argues that both perspectives are important to understand strategic change with small firms in the light of demographic change, which represents a long-term process that unfolds gradually and involves both considerable uncertainty and complexity, and new market opportunities. Informed by conceptual insights about the strategic change management of small firms in declining business environments, particularly the work of Harrigan and Porter (1983), the paper investigates how strategy-formation in the context of demographic change takes place with regard to small firms in local markets. Based upon a mixed-method approach and an exploratory research design, empirical evidence is presented that stems from a postal survey and a series of qualitative interviews with narrative cores (Boje, 2002; Czarniawska, 1998) in German regions that are severely affected by demographic change.

The study contributes to the contemporary debates in the field of strategic change and small business management in a twofold way. First, it explores the role of strategic behaviour and the adaptation of small firms to demographic change by applying the model developed by Harrigan and Porter (1983) to this context. Although the strategic recommendations have been used for studying firm-level adaptation to industry decline (Filatotchev & Toms, 2003; MacLachlan, 1992), demographics as a cause of market decline have not been addressed. In the light of the growing importance of the contemporary demographic challenges for businesses (Kohlbacher, Herstatt, & Levsen, 2014; Thompson & Thompson, 2009), the paper particularly wants to shed light on the perspective of small firms. Second, the study also aims to elaborate the factors that matter for strategic change processes of small firms, notably with regard to complex and uncertain market transformations (see, for example, Smallbone, Deakins, Battisti, & Kitching, 2012; Burpitt & Valle, 2010). The factors that are highlighted for this process are awareness or sense-making of demographic change (Leick, 2017; Hannon & Atherton, 1998), and proactivity (Becherer & Maurer, 1999).

With regard to small businesses, the study confirms the appropriateness of the typology of the adaptive strategies suggested by Harrigan and Porter (1983) for declining markets and industries. The empirical findings point to a predominance of market leadership strategies. The results therefore suggest that, when being confronted with shifts in demographics and a resulting market change, firms prefer to embark on an opportunity-seeking, learning-based approach in order to stay in the market and sustain their long-term competitive advantage, instead of exiting from the market. However, non-strategic behaviour is found as another adaptive strategy because of the long-term and, partly, uncertain effects, and the resulting complexity of demographic change as an environmental factor. Besides market leadership, non-strategy then seems to represent another strategic option for small businesses to cope with the long-term impact of demographic change.

The remainder of this paper is organised as follows: the next part presents a literature review, which contains the conceptual underpinnings for the present study. After briefly describing the research method and qualitative study design, the empirical analysis is presented, followed by the discussion, conclusion and research limitations.

## **Literature Review**

### *Strategy-formation: Planning versus Practice as Two Dimensions*

For a long time, the strategy-formation of firms has been viewed as a linear planning process, with strategies evolving in a stream of rational, intentional business decisions and subsequent action-taking to pursue a well-defined and long-term goal (Mintzberg, 1987; Mintzberg & Waters, 1985). This ideal-type version of a strategy-formation model conceptualises a formal planning procedure, which a firm establishes out of its daily operations and which is expressed by its leaders and management. It has, however, been acknowledged that emergent, and often unintentional, strategies are another approach to strategy-formulation, which result from constant, yet incremental and practiced operations, and modifications of established ways for conducting business operations in practice (Mintzberg & Waters, 1985; Quinn, 1984). The latter perspective has more recently been debated as a '*practice turn*' (Chia & Holt, 2006). Indeed, Jarzabkowski (2004, p. 529) claims that '*(w)e should examine strategy not as something a firm has, but something a firm does*'. Originating from criticism of purely rationalist-analytical understandings of strategies that emerge as a logical series of activities and decisions, the recent strategy-as-practice approach stresses the unstructured and unintentional character of the strategies that are embodied in the practices and discourses of executives and leaders within business organisations (Fenton & Langley, 2011).

### *Strategic Change and Adaptation*

Particularly in dynamic business environments, improvisation and practiced behaviour (Elbanna, 2006; Fletcher & Harris, 2002; Schwenk, 1995; Hart & Banbury, 1994) complement rational and sequential information gathering, processing and management within business organisations (Slevin & Covin, 1997; Lozada & Calantone, 1996). Another crucial factor influencing the strategy approach of firms is awareness of environmental uncertainty (Hannon & Atherthon, 1998); it refers to intuition and the perception of risks or adversity for the strategic decision-making (Saebi, Lien, & Foss, 2016; van Gelderen, 2012; Elbanna, 2006; see, also, Mattson, Corsaro, & Ramos, 2015). When turbulence or crisis in the external business environment challenges firms (Schmitt, Barker III, Raisch, & Whetten, 2016; Anderson & Nielsen, 2009; Chakravarty, 1982), learning is another important element pertaining to the strategy-formation of firms (Zollo & Winter, 2002; Rajagopalan & Spreitzer, 1997). Casson (2005, p. 333) emphasises that the approach to taking business decisions in such contexts is that of an entrepreneur who screens information, and learns and innovates against the backdrop of the external challenges. Strategic change against turbulences in the markets is thus based upon a balance of improvisation and flexibility, on the one hand (Cope & Watts, 2000; Ebben & Johnson, 2005), and planning, foresight and information

management, on the other (Casson, 2005; Lozada & Calantone, 1996; see, also, Saebi *et al.* 2016).

Chakravarty (1982, p. 35) stresses that these activities are organised as a continuous process, in which firms use their internal resources to learn incrementally, enhance their strategic capabilities, and improve their competitiveness. Such actions, both as long-term strategic adaptation and ‘*fire-fighting*’ short-term activities (Smart & Vertinsky, 1984), need to turn challenges into opportunities (Wan & Yiu, 2009). Hence, strategic responses to market change require both sufficient planning, including information management, in order to identify the challenges and opportunities associated with market change, and flexibility and a learning-based approach in order to adapt.

### *The Strategy-formation of Small Firms*

Describing the strategies of small firms with formal planning approaches alone ‘*can be particularly inappropriate*’ (Barnes 2002, p. 131). Instead, the strategy-formation of small firms is associated with the implicit and informal formulating of strategies (Schindehutte & Morris, 2001), which requires both awareness of the changes taking place and a minimum of planning activities (Hannon & Atherton, 1998). Emergent strategies resulting from market opportunities need to be identified (McCarthy, 2003; Barnes, 2002). Hence, rapid learning is involved (Chen & Hambrick, 1995), based upon sufficient learning capabilities (Jones, 2004). Particularly when market changes force firms to rethink established concepts and develop new ones, small firms need a leadership approach and a corresponding mentality to steer themselves through the changes (Blackburn, Hart & Wainwright, 2013; Kickul & Gundry, 2002; Becherer & Maurer, 1999). Barnes (2002, p. 133) notes that learning for small firms is strongly influenced by the opportunity-seeking mentality of the individuals who represent the firm, *i.e.*, the founder, the owner or the key managers.

Changing business environments may also induce firms to reap market opportunities and use competitive advantages based upon flexibility (Ebben & Johnson, 2005; Chen & Hambrick, 1995). Thus, moving quickly, reaping first-mover advantages, learning rapidly to adapt to new constellations, and acting efficiently are important elements of the strategic approach of small firms in order to cope with such environments. Small firms often exert personal ownership and leadership that is capable of seeking newly emerging market opportunities, whilst being endowed with an ability to take decisions quickly (Mintzberg & Waters 1985, p. 260). In this respect, Schindehutte and Morris (2001) point out the role of incrementalism in the approach of small firms to learning for their adaptation to market or

industry changes. Becherer and Maurer (1999, p. 3) and Kickul and Gundry (2002) emphasise that proactive behaviour towards environmental changes constitutes a disposition that is positively associated with a firm's survival (Van Gelderen, 2012). The latter idea is closely related to the McGrath's (2013) concept of transient competitive advantage, which needs continuous reflection and renewal to counter business changes.

Contrary to such an opportunity-seeking approach to adaptation, resistance to change and non-strategic behaviour are also common behavioural patterns to be observed with small enterprises (Schindehutte & Morris, 2001; Inkpen & Choudhury, 1995). Notwithstanding these stylised facts, the responses to change in the firms' business environment can vary considerably, which is, for example, reflected in the Miles and Snow (1978) typology on the nature of a firm's interaction with the environment (Desarbo, Di Benedetto, Song, & Sinha, 2005).

#### *Demographic Change as a Context of Crisis and Persistent Market Change*

Demographic change has long been discussed as a context for market change, implying strategic positioning and adaptation on the part of firms (McRae, 1996; Greller, 1990; Johnson, 1990; Pol, 1986). The topic has re-entered the agenda of business, management and marketing scholars only recently. For instance, Kunisch, Boehm and Boppel (2010), Kuebler, Mertens, Russell and Tevis (2009), and Strack, Baier and Fahlander (2008) discuss both the inherent character of contemporary demographic challenges and their effects on business organisations. Accordingly, demographic change represents a context of crisis and turbulence in the business environments of firms and in national or local markets for various reasons. First, labour scarcities are on the rise, with shifts from young to aging cohorts of the local potential of employees, a trend that has an impact on the recruitment opportunities for firms, both at the level of managerial and general staff (Tulik, 2014, Thun, Größler, & Miczka, 2007). Demographic change also has long-term implications for the human resources (HR) and recruiting practices or policies of firms (Verworn, Schwarz, & Herstatt, 2009). Second, particularly those firms that predominantly serve or depend on local sales markets will face changing consumer preferences in which elderly consumers with their specific and/or new preferences gain in importance (Kohlbacher, Herstatt, & Levsen, 2014; Thompson & Thompson, 2009; Kohlbacher & Herstatt, 2008). Third, the challenges regarding company succession is another strategic topic associated with demographic change, for example, for firms from Germany (Deutsche Bank Research, 2013).

All these changes are likely to evolve slowly and have, at least partly, a non-predictive character; notably, the medium- and long-term market shifts will be quite difficult to identify and respond to at an early stage, especially from the perspective of those small firms which do not have long-term market screening and planning instruments (Leick, 2017). Firms that strongly depend on local markets, for example, in the area of recruiting, or because they sell primarily locally (see Jones, 2004), will have to reconsider their business model, and thus need to seek adaptive strategies to cope with demographic change, taking into account the associated complexities and uncertainties. Although both market size and market potential may decrease because of demographic change, such a context also offers new business opportunities, for instance, through access to new and growing market niches in the so-called ‘*silver economy*’ (target groups representing elderly, wealthy consumers; see Kohlbacher & Herstatt, 2008), based upon product innovation in consumer goods, customisation or new promotional approaches (Kohlbacher *et al.* 2014). In a similar vein, firms may design and implement innovative approaches to cope with rising shortages of labour (Verworn *et al.* 2009; Streb, Voelpel, & Leibold, 2008).

#### *End-game Strategies for Demographic Change? A Typology of Adaptive Strategies*

While strategic responses to market changes have been investigated for small rural firms (Young, 2010; Stathopoulou, Psaltopoulos, & Skuras, 2004), small firms in crisis-ridden environments (Battisti *et al.* 2013; Smallbone, Deakins, Battisti, & Kitching, 2012; Soininen *et al.* 2012; Sternad, 2012) and declining markets (Bamiatzi & Kirchmaier, 2012; Bacot, 2011; Burpitt & Fowler, 2007), this is not the case for the issue of demographic change. Looking back in the strategic management literature, it is Harrigan (1980, 1985) and Harrigan and Porter (1983) who provide a generalisable matrix for competitive strategies in declining industries and markets, which they call ‘*end-game environments*’. In this conceptual model, demographic change is a source of market decline along with technological obsolescence and the rise of new consumer preferences. Such end-game environments are characterised by high levels of uncertainty with regard to the current and future demand of consumers, which can be circumscribed as the problem of ‘*coping with substantially less demand for the products of such a business ... where there is little hope for re-establishing consumption at its formerly high levels*’ (Harrigan, 1980, p. 1). The model developed by Harrigan and Porter (1983) considers the nature of the market and the demand as well as the structure of industry in question and outweighs the firms’ internal strengths and resources against external influences.

Within this framework, Harrigan and Porter (1983) suggest four different types of adaptive strategies, described as:

(a) *increasing the investment* to gain dominance and cost-efficiency, thereby turning into the *market or industry leader*. For example, market leadership in a declining market or market segment can be achieved by avoiding price competition and increasing the investment in a specific product or service that is suited to reap above-average profitability;

(b) *holding the level of investment* in the short term and waiting for a *market niche* to be developed; accessing niche markets is a related strategy to (a) when segments with predictably stable demands are likely to prevail in an overall declining market or when high returns are possible based on the firm's competitive position and/or the industry structure;

(c) *selective shrinking* with the market to reposition the firm in a changing market and *harvesting* the investment; and

(d) *divestment* as a *quick exit* from the shrinking market. Harvesting as a long-term and divestment as a short-term adaptive strategy to declining markets can be considered as a controlled disinvestment, for instance, by reducing the range and breadth of the products/services offered, focusing on large customers only, or cutting down on pre- or post-sale-services within a short or long period of time.

Choosing the '*ideal*' strategy type (Table 1) thus depends on various factors such as the firm's competitive position in the market, the industry traits, the price-elasticity of demand, opportunities for product differentiation, the availability of profitable niche markets, the degree of rivalry in the market, and the speed and certainty of market decline. Consequently, Harrigan and Porter (1983) derive different strategy recommendations for various constellations of a firm's resources and the market. With regard to demographic change, the matrix highlights the different adaptive strategies, which are applicable for local sales markets. Firms can either strive to become a local market leader in an overall declining market, which may include strategies to achieve leadership in niche markets (for example, by focusing on the growing target group of wealthy elderly consumers), or they might consider harvesting as a gradual, long-term, or divesting as a short-term adaptive strategy in response to demographic change.

*(Table 1 about here)*

Although Harrigan's and Porter's simple model can be criticised for its prescriptive character or because it condenses the variety of strategic options into four options only, the

strategy recommendations provide important insights into the two basic decisions that firms should consider when strategically steering through demographic change in their local markets: Stay in the market or leave it? And how to achieve this, *i.e.*, through radical *versus* gradual steps?

### **Research Design and Method**

In order to study the strategic adaptation of small firms with regard to local sales markets, an exploratory mixed methodology-approach is used, which combines a survey among small firms with narrative interviews in three German regions affected by demographic change. The research design is organised in two stages: the first stage, conducted in 2011, includes a postal survey of 589 small firms in the region of Upper Frankonia (Bavaria in Southeast Germany) registered in the Bisnode database (formerly the Hoppenstedt firm database), one of the leading business information databases in Germany ([www.bisnode.de](http://www.bisnode.de)). Upper Frankonia has lost 3.4 per cent of its population between 2003 and 2010 and is expected to face another decline of 9.2 per cent by 2029, which is well above the German average (-1.5% population decline by 2030, [www.destatis.de](http://www.destatis.de)). The age-dependency ratio, *i.e.*, the number of retired persons aged over 65 in relation to the number of people in the active working-age group (20 to 64 years), in the region will amount to 57.8 by 2035 (estimates for Germany ranging between 54 and 58 by 2030, [www.destatis.de](http://www.destatis.de)). With a response rate of 13.7 per cent (n=81), the survey was based upon a structured questionnaire which sought for general patterns in the key respondents' responses. Thematically, the postal survey focused on the perceptions of firms with regard to demographic change and the strategies applied to cope with it.

In a second stage, 18 complementary qualitative interviews were conducted in two rural German regions in Saxony Anhalt, East Germany (2011), with 11 firm interviews, and in the Rhineland Palatinate, West Germany (2013), with 7 interviews. Both regions are facing comparable challenges such as population decline (forecasts for Saxony Anhalt: -18.0 per cent by 2025, and Rhineland Palatina: -12.3 per cent by 2035) and ageing (forecasts for age-dependency ratios in Saxony Anhalt: 58.3 by 2025; the Rhineland Palatinate: 52.0 by 2035). Interview guides with a low degree of structure and a narrative core were used to look openly into case-specific '*stories*' that were told about how firms actually perceive and address demographic change, thereby complementing the findings from the postal survey with in-depth observations at the level of the individual firm. The interviews were of 45 to 150 minutes in length and were conducted with owner-managers or senior executives, all of them being transcribed and coded afterwards. In the second stage, qualitative data analysis was

applied, using coding techniques and the categorisation of emerging topics, as well as patterns of similarities and dissimilarities across the interviews with regard to the most important concepts and themes (for example, strategic *versus* non-strategic behaviour, specific adaptive strategies and the overarching categories in the Harrigan/Porter model to which they belong). Tables 2 and 3 summarise the profiles of the firms participating in both stages, and highlights that the focus of this study is on small firms which are embedded in local markets.

*(Tables 2 & 3 about here)*

With regard to the selection criteria, firms in both interview stages were selected according to their local market sales and/or their recruiting activities, and their firm size as small businesses. Most of the firms covered in the samples are affiliated with consumer-oriented production and services and have a predominantly local market orientation. The subject firms are rooted in their home region; they were founded or have their headquarters in the area, and thus they are very much affected by changes in local markets and business environments. The selection criteria for firms were also aligned to Eisenhardt's (1989) approach for case-study designs, which suggests choosing illustrative cases that support theory-building. The focus was thus set on firms that have something to report when it comes to the issue of demographic change, and firm strategies for local market change. With regard to the range of topics addressed, the themes included the general perceptions of the firms about demographic change both at the level of the individual firm and the local market, the strategy-formation undertaken by firms in response to demographic change, their strategic *versus* non-strategic approach *vis-à-vis* demographic change, and the specific adaptive strategies of firms, *etc.* (Table 4).

*(Table 4 about here)*

The research design adopts an exploratory and primarily qualitative approach, which seeks to shed light on the specific phenomena under investigation, rather than confirming generalisable patterns. Consequently, and in line with the suggestions made by Eisenhardt (1989), Eisenhardt and Graebner (2007) and Yin (1994), the methodological approach used in this study does not claim to achieve statistical representativeness; instead, it highlights the specific features of individual cases in order to interpret observations that might contribute to filling gaps in the research. To this aim, the narrations provided by the key informants were used to obtain in-depth insights into the discourses shaping the perception of demographic change and the firms' reactions or actions to cope with it, be they strategic and non-strategic.

Narrations are an important element in the contemporary management and strategy literature that convey meaning and support sense-making about certain events. Examples of such narrations for organisational or strategic change accounts can be found in Fenton and Langley (2011), Doolin (2003), Vaara (2002), and Dunford and Jones (2000). The outcome of narrations, to wit, narratives, can be considered as accounts of events, presented as stories that have been told to convey meaning about ‘*a sequence of actions and experiences done or undergone by a certain number of people, whether real or imaginary*’ (Boje, 2002, p. 2; see, also, Czarniawska, 1998). In the present research-design, story-like descriptions are being interpreted to make sense of the issues recounted by the interviewees (see Siggelkow, 2007). This is done by uncovering or revealing the emerging themes and patterns about the firm-specific perceptions and their adaptive strategy-formation for local markets in response to demographic change.

## **Empirical Analysis and Discussion**

### *Perceptions of Demographic Change and Strategy-formation*

Although the firms have different perceptions with regard to demographic change, a common denominator which cuts across the postal survey and the interview series is that demographic challenges are clearly perceptible at the level of the individual firm. Two thirds of the firms in the postal survey (66.7%, n=81) indicate that they perceive demographic challenges in their home markets. However, only 55.6 per cent of the enterprises surveyed proactively deal with the issue, which clearly represents a paradoxical finding at first sight.

With regard to the most important effects of demographic change (Figure 1), many firms equate demographic change with changes in the labour markets, for example, the shrinkage of the total labour force and the lower availability of skilled workers and trainees. The finding that labour-market challenges are the most perceptible effect of demographic change on firms is also reflected in the statements provided by firms in the second interview stage (Quotations 1 & 2).

*(Figure 1 about here)*

‘...With all the young persons leaving the region (...). This place does not attract people from elsewhere. We are willing to pay extra bonuses and

incentives, because motivated people should earn more. Nevertheless, it is hard to recruit new staff here.’ (Quotation 1, firm no. 3)

‘Demographic change means that I have to invest more to recruit young people. ... We have been receiving less and less applications over the past few years, and the level of qualifications of the applicants is decreasing as well.’ (Quotation 2, firm no. 5)

However, given their local market orientation, many firms also observe that the number of elderly customers is growing while young customers, in particular, are decreasing in numbers. For firms in consumer-oriented industries and the service sector, ageing consumers represent a challenge not only because they show different preferences with regard to products, product design, promotion/marketing and after-sales services, but also because they express a desire for new services (Quotations 3 & 4). By contrast, company succession and changes in local supplier networks caused by demographic change are clearly less important (Figure 1).

‘We observe that many of our customers are elderly people who show great difference in their buying behaviour relative to younger ones. They want more service, but also stick to the more traditional products and are not very flexible buyers when it comes to trying out new clothing and textiles.’ (Quotation 3, firm no. 17).

‘The public transport service system is where you notice demographic change. New services are being demanded which did not exist before.’ (Quotation 4, firm no. 12).

Although demographic change does produce important effects on firms, only 19.3 per cent of the firms in the postal survey reported that they already applied specific strategies to deal with these effects, whereas the majority of firms surveyed were not yet ready for strategy-formation or rejected building strategies in response to demographic change (Figure 2). While it is quite self-explanatory to establish a causal link between the perception of the specific effects of demographic change and strategy-formation, as a result, at individual firm level, it is questionable what actually drives firms that perceive some of these effects to address the observed changes in terms of both developing and applying strategies. As Table 5

highlights, a proactive stance towards demographic change as a topic of strategic importance answers this question about the strategy-formation process of small firms. Therefore, proactive behaviour, coupled with the observation of any effects, be they positive, be they negative, drives firms to respond strategically to demographic change.

*(Figure 2 & Table 5 about here)*

### *Strategic versus Non-strategic Responses to Demographic Change*

Indeed, two opposite patterns of responses emerge from the narratives provided by the key respondents. Part of the firms take a strategic approach to tackle the complex challenges associated with demographic change, based upon the search for and the collection of relevant information, intensive market research, learning-by-doing and experimentation. For instance, these firms proactively try to access new, and growing, market niches in their home regions or elsewhere, or they develop new or modified products and services, hence they innovate. An important element of their strategy-formation process is information management, *i.e.*, gathering and processing the relevant information regarding the impact of demographic change on the local business environment (Quotation 5). While some firms screen and interpret official statistics about demographic trends, others have access to informal sources provided by business partners or local business networks. In some cases, the key respondents state that the firms use formal planning tools. Besides, the owner-managers show a learning-based mentality, being willing to experiment with established products or processes, to change them according to newly emerging needs or changing demand from their local markets.

‘I am always trying to get information and listen to many presentations on this topic. We also hosted a Berlin-based researcher who came to do a survey among local firms. When he presented the results of the survey, we became aware of the huge changes that lie ahead due to demography.’ (Quotation 5, firm no. 14)

By contrast, other firms surveyed had no clear-cut strategic outlook with regard to demographic change, they either downplay or even ignore the effects that they observe in the local markets. Such cases of reactive strategy-formation or non-strategic behaviour (Schindehutte & Morris, 2001; Inkpen & Choudhury, 1995) are associated with short-term, operational problem-solving, which dominates the firms’ planning approach to take business

decisions (Table 6). In other cases, firms respond by developing action-plans, be they intentional, be they emergent, only as opportunities or problems arise. Some firms ignore potential threats regarding market change even if they perceive the shifts in the local demographics and their effects, for example, rising labour scarcities or new consumption patterns in their established markets. Finally, some firms clearly state that they feel that they are disoriented *vis-à-vis* the complex challenges that are hard to anticipate. Altogether, there are manifold reasons why firms do not adopt a proactive strategic approach to deal with demographic change (Table 6 and Figure 3), which are partly associated with the cumulative nature of the effects of the latter (Quotations 6 & 7):

‘Nothing hurts more than the pain you are feeling now. It is not the pain you might be feeling next year. This means... many local firms are pushing those challenges aside or they are not yet facing them.’ (Quotation 6, firm no. 1)

‘... small craft firms already have huge problems hiring staff. They are not used to train young apprentices on their own. They have always hired external staff. Now the situation is changing, and they become increasingly aware that they have to care themselves for their future staff.’ (Quotation 7, firm no. 5)

(Figure 3 & Table 6 about here)

#### *End-game Strategies to Adapt to Demographic Change: Empirical Evidence*

Based upon the schematic options for strategies in declining markets derived from Harrigan (1980, 1985) and Harrigan and Porter (1983), specific adaptive strategies for local markets are categorised as follows (Table 7). Firms apply *leadership strategies* in order to remain a local market leader in spite of declining numbers of customers, ageing consumers, and changes in their preferences, *etc.* By contrast, *divestment strategies* aim to shrink the firm size intelligently with the local market or even leave it. In addition to these competitive strategies, which Harrigan and Porter (1983) describe, *local networking* and *expansion to non-local markets* are identified as two complementary strategies, which, in this case, accompany adaptation through leadership or divestment strategies for local sales markets.

(Table 7 about here)

*Market leadership strategies.* When applying adaptive strategies, firms seek to sustain their position as a local market leader, and either build or defend niche positions in an overall declining local market. Several different strategies that fall into this category can be identified

with the firms interviewed, for example, product adaptation and product development in accordance with the specific wishes of elderly customers and customization, which is used to access the so-called ‘*silver agers*’ (Kunisch *et al.*, 2010; Kohlbacher & Herstatt, 2008). As Quotation 8 highlights, for some firms, demographic change is even associated with a new, sustainable business model that supports their specialisation in specific niche markets. A repeated pattern found in the sample is that firms combine several strategies in order to sustain leadership. Product innovation takes place through the introduction of new products or services, the upgrading of established products through extra services, the use of strong brand names and logos, and/or the offering of a broader range of services, often in packages, through local business networks. These strategies reflect the wish to achieve leadership in local markets as the overarching competitive strategy.

Investments in promotional activities, events, or product/service development and service provision is another example of such adaptive strategies. In some cases, firms establish a strategy that combines high-quality products/services, customisation and local business networking to differentiate themselves from local competitors that offer standard services only. Niche strategies do not always address elderly customers; some examples highlight that firms specialise in younger customers in order to sustain leadership and defend a strong position in that market niche. Nevertheless, focusing on the ageing population as a growing target groups is an important pattern among the firms interviewed.

‘Demographic change was the main reason for us to start our business as you see it now. Our health and spa club is designed for people over 40, which was a must for us at this ageing location. Young adults will sooner or later leave this place. People over 40 who start doing work-outs will stay as our customers for a couple of decades at best.’ (Quotation 8, firm no. 7)

*Harvesting and divestment strategies.* There is less evidence of market exit strategies, particularly of quick divestment. When firms choose exit options, they gradually reduce part of the range of products/services that they previously offered to local customers or stop serving branches located in the most disadvantaged areas of the home market. In other cases, firms focus on top-selling or high-return products only. Some firms cannot give up local markets and compensate losses in local markets by expanding their non-local operations, because of legal or institutional restrictions (for example, regional banks) and thus choose gradual divestment and harvesting as market exit strategies. However, these decisions are always embedded in a market leadership strategy to adapt to demographic change by staying

in the market, a strategy that also encompasses customers in stable or growing niche markets (such as wealthy elderly consumers in the case of regional banks). In some cases, firms focus on specific segments of the market alone and exit from other market segments, but continue to offer their products/services as part of a local network of suppliers or a local supply-chain. Based upon this observation, local business networking is considered as another adaptive strategy, along with market expansion elsewhere.

*Market expansion and local business networking as complementary strategies.* Business networking among local firms, particularly with customers and suppliers (vertical supply-chain) or potential competitors (horizontal co-operation), is another strategy for small businesses to adapt to demographic change. By adopting network-based strategies, firms are able to focus on profitable niches, whilst keeping their range of products complete or extending it in spite of market decline based upon network complementarities. Through such networks, firms can maintain full-package offers, but only specialise on those products or services with a sufficiently high potential that allows them to sustain a market-leader position at home, thereby safeguarding long-term niche markets. However, in some cases, fierce rivalry hampers such co-operation. In addition, the findings point out that market expansion by selling outside the local market and/or exporting abroad is another strategy that accompanies adaptive strategies for local markets. It is, however, no option for locally-bound firms, for example, firms facing high levels of transportation costs in the service sectors, or firms with legal or public mandates to serve local markets. These firms are not able to offset decreasing sales in local markets by expanding both their operations and sales to other domestic or export markets. Smart adaptation to shrinkage is a necessity then, and not just an option for their strategic approach (Quotation 9).

‘Those firms that serve national and international markets may compensate for losses in the local market and position themselves in boom regions. But the small, local firms are trapped inside the shrinking market and have to ask themselves: Do I shrink with the market or do I take action to grow against the market?’ (Quotation 9, firm no. 6)

### *Discussion*

Do firms serving local markets steer through tough times in the light of contemporary demographic change? Based upon an empirical study of small firms from Germany, the

present paper reveals three important insights into the adaptive strategy-formation of small enterprises that answer this question.

First, the strategic responses of small firms to demographic change can be described as the interplay of foresight and planning, on the one hand, representing the rationalist approach to strategy-formation (Mintzberg & Waters, 1985; Lozada & Calantone, 1996), and flexibility and learning-based activities, on the other (Cope & Watts, 2000; Kickul & Gundy, 2002), which is rather in line with the idea of emergent strategies (Mintzberg 1987). Confronted with market change and decline caused by demographic change, most locally-embedded firms proactively seek new market opportunities, access and develop markets or market niches, re-position themselves and innovate in terms of adapting their products/services, or even change their established business models. In the process of strategy-formation, proactive behaviour turns out to facilitate such strategy-formation and adaptation to demographic change (Becherer & Maurer, 1999). Moreover, learning plays an important role in this process, and includes learning by experimenting and incrementalism (Schindehutte & Morris, 2001). However, a firm's ability to learn and adapt to market change is supported by thorough information management, which is needed to deploy market-specific knowledge as a resource. Information management involving the search for, screening, and processing, of the relevant information about local demographic challenges and opportunities takes place both formally or informally. Another facilitator of the strategy-formation of small enterprises is local business networks, which support small firms through their access to complementary resources, for example, demography-related information and know-how. The empirical evidence stresses that firms build small-scale local value-chains through business networking, thereby sustaining a competitive position in an overall declining market. Consequently, the firms surveyed prepare for market change caused by demographic shifts based upon a solid mix of intentional planning and information management, and emergent, improvised actions to respond to the opportunities that present to themselves (Lozada & Calantone, 1996; Chen & Hambrick, 1995; Mintzberg; 1987).

Second, adaptation to complex and partly non-predictable changes in local markets affected by demographic change is associated with strategies to achieve leadership positions in established markets or to open up new market niches. While this type of strategy partly reflects the cumulative nature of the effects of demographic change, it also emphasises the risk-taking and opportunity-seeking nature of entrepreneurs who are steering their business organisations through demographic shifts with their concomitant effects on local markets (Blackburn *et al.*, 2013; McCarthy 2003; Hannon & Atherton, 1998). The emerging market

opportunities associated with this change can be linked to the broadening of the firm's range of products/services, specialisation in profitable and growing market niches, accessing new consumers and target groups in the changing markets, and customisation. Gradual or quick divestment and exit strategies are clearly less important to small firms. Firms using such harvesting and divestment strategies combine them with other adaptive strategies to safeguard their competitive advantage in the changing business environment. Again, this finding might reflect the gradual changes caused by demographics, those that do not imply radical steps and responses. Business networking is another strategy, which accompanies market leadership, market expansion to other parts of Germany or exports, and divestment strategies used for intelligent downward resizing. The combination of different strategies for similar challenges according to the firm's temporal needs and resources fits to the concept of transient competitive advantage that requires continuous re-positioning and sustainable business model adaptation on the part of firms and leaders in order to survive in a fast-changing marketplace (McGrath, 2013).

Third, small firms also show no strategic behaviour *vis-à-vis* changes in local markets caused by demographic change; instead, they take business decisions to cope with demographic change and its effects, by using a non-strategic approach (Schindehutte & Morris, 2001). The findings point out that such planned or unintentional myopia towards both the business challenges and the opportunities associated with shifting demographics (Leick, 2017) can represent a strategy on its own (see, also, Inkpen & Choudhury, 1995). Non-strategic behaviour thus reflects the character of the demographic change processes emerging as a complex and temporally remote event from the perspective of the individual small firm. Facing limited resources, it might be a rationalist approach to strategy-formation for some firms simply to ignore such long-term time changes because they only partially overlap with the firms' short-term planning horizons, particularly with small enterprises (Leick 2017, p. 21).

In sum, while some firms do steer through tough times in their search for a renewal of their once thriving business models, demographic change brings an opportunity to other firms with local markets, allowing them to build competitive adaptive strategies (Harrigan and Porter 1983).

## **Concluding remarks**

By elaborating on these insights, the study specifically contributes to some contemporary debates about the strategic change management of small businesses in two respects. First, whilst generally confirming the strategy-as-process perspective (see Elbanna, 2006), both emergent, practiced strategic behaviour (Fenton & Langley, 2011) and intentional, rational planning approaches (Mintzberg & Waters, 1985) are appropriate conceptual points of departure to describe the adaptation of small, locally-based firms to demographic change (see Barnes, 2002). Perceptions of the risks and opportunities linked to demographic change and sense-making for them internally, *i.e.*, in the small firm's organisation, and, externally, with local customers and stakeholders are an important element in this description (see Hannon & Atherton, 1998; Leick, 2017). Proactivity in terms of seeking information about the changes and the market opportunities that they might bring are also important to understand the adaptation of small firms in this context of market turbulences or crisis (Kickul and Gundry, 2002; see, also, Lechner & Gudmundsson, 2014). Second, the study also contributes to the practical, managerial literature on demographic change (e.g., Tulik, 2014; Strack, Baier & Fahlander, 2008) by describing the variety of the forms of adaptive strategy-formation for local markets ranging from short-term reactive responses such as '*fire-fighting*' (Smart & Vertinsky, 1984) and long-term strategic planning to non-strategic behaviour in terms of negligence of demographic change (Inkpen & Choudhury, 1995).

With regard to public-policy implications, the study pleads for firm-specific, individualised policy approaches to support the strategy development particularly of small firms *vis-à-vis* demographic change. However, the typology of adaptive strategies developed by Harrigan and Porter (1983), which is generally confirmed with the empirical research presented, highlights the main directions of strategic change and adaptation, *i.e.*, perseverance in the changing market *versus* gradual or quick market exit. The primary strategy used, market leadership, can be a point of reference to provide assistance to small firms, because this type of strategy is used in combination with other strategies including divestment. Even if it is much more sophisticated to deal with the non-strategic behaviour of small firms, such behaviour should be addressed as well by policy initiatives. Supporting business networks at local level that integrate small firms can be an approach to overcome resistance to, or negligence of, strategic adaptation to demographic change. As the effects of long-term demographic shifts might be too far away from the short-term decision-making approaches of small enterprises, public policy can particularly support the awareness and sense-making of these effects.

This study, however, faces some limitations. As qualitative research, the results presented are not generalisable. Moreover, the exploratory research approach only stresses specific patterns, but it does not confirm them against *a priori* given research propositions. For future research, follow-up studies should thus seek to confirm the findings of strategic *versus* non-strategic approaches including the pattern of adaptive strategies identified. As such, demographic change is an important, yet under-researched context not only in the field of small business management but also in the contemporary debates on strategic change, although particularly small and locally-embedded businesses are perhaps more sensitive to these kinds of local market changes than their large and global counterparts.

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**Table 1: Strategic matrix for market change and decline**

	<i>Firm has relative competitive strengths</i>	<i>Firm has relative competitive weakness</i>
<i>Favourable industry structure for endgame</i>	Increase the investment or hold the investment level (leadership or niche)	Shrink selectively or harvest the investment (harvest or divest quickly)
<i>Unfavourable industry traits for endgame</i>	Shrink selectively or harvest the investment (niche or harvest)	Short-term market exist (divest quickly)

Adapted from Harrigan and Porter (1983).

**Table 2: Firm demographics, interviews stage 2 (N=81)**

<i>Firm size (number of employees)</i>	<i>N=81</i>
<10	9,9%
10-49	66,7%
50-249	21,0%
>250	2,4%
<i>Corporate integration</i>	<i>N=80</i>
Yes	6,2%
No	93,8%
<i>Importance of local sales markets</i>	<i>N=79</i>
Very important	74,7%
Important	7,6%
Less or no importance	17,7%

**Table 3: Firm demographics, interviews stage 2 (n=18)**

Firm No.	Main industry	Firms size (employees)	Foundation (year)	Local embeddedness	
				Sales	Recruiting
1	Manufacturing of health and fitness equipment	80	1947		✓
2	Retail trade	1	1993	✓	
3	Travel services	3	2007	✓	✓
4	Education and training services	n.i.	n.i.	✓	✓
5	Construction and sanitary installations, heating, ventilation, air conditioning	79	1957	✓	✓
6	Financial services	95	1876	✓	✓
7	Health and spa services	32	2001	✓	✓
8	Health services	1097	1896	✓	✓
9	Education and training services	55	1993	✓	✓
10	Environmental services	602	1990	✓	✓
11	Education and training services	4	1930	✓	✓
12	Tourist services	25	1999	✓	
13	Food manufacturing	160	1958		✓
14	Accommodation and tourist services	7	1820	✓	
15	Tourist and transportation services	3	2000	✓	
16	Accommodation and tourist services	1	1991	✓	
17	Retail trade	26	1991		✓
18	Food manufacturing	33	1810		✓

**Table 4: Interview themes and selected guiding questions (Excerpt, interview stage 2)**

Themes covered in the interviews	Sample questions	Theoretical points of departure associated with the themes covered
Perceptions of demographic challenges	<ul style="list-style-type: none"> <li>- What does demographic change mean to the owner-managers or senior executives?</li> <li>- Where (local labour, sales markets, supply chains and business networks, <i>etc.</i>) do they perceive demographic challenges? Which ones?</li> </ul>	<ul style="list-style-type: none"> <li>- Strategy-as-process (Elbanna, 2006; Mintzberg &amp; Waters 1985)</li> <li>- Strategy-as-practice (Jarzabkowski, 2004)</li> </ul>
Awareness of market changes due to demographic change	<ul style="list-style-type: none"> <li>- Which changes do the respondents observe in local markets?</li> <li>- How do the changes observed affect their own firm? (Examples)</li> </ul>	<ul style="list-style-type: none"> <li>- Awareness, perceptions and sense-making with respect to strategic change (Hannon &amp; Atherton, 1998)</li> </ul>
Strategy-formation in response to demographic change	<ul style="list-style-type: none"> <li>- Which specific strategies do the firm and its leader apply to cope with and adapt to demographic change? (Examples)</li> <li>- Has there been a trigger for adaptive strategy-formation and if so, which one?</li> <li>- Does the firm react to changes occurring, or does it proactively take steps in terms of strategies in response to demographic change?</li> </ul>	<ul style="list-style-type: none"> <li>- Adaptive strategies and adaptive strategy-formation (Harrigan &amp; Porter, 1983; Desarbo, Di Benedetto, Song &amp; Sinha 2005)</li> <li>- Learning-based and flexibility-based approaches (Ebben &amp; Johnson 2005; Jones 2004; Kickul &amp; Gundry, 2002)</li> <li>- Information and planning-based approaches (Schindehutte &amp; Morris, 2001; Lozoda &amp; Calantone, 1996)</li> </ul>

**Table 5: Perceptions of demographic challenges and strategy-formation**

		<i>Proactive dealing with the issue of “demographic change”?</i>	
		<i>Yes</i>	<i>No</i>
<i>Developing corporate strategies in response?</i>	<i>Yes</i>	30,2%	6,7%
	<i>No</i>	69,8%	93,3%
Chi square: 6,011, p<0,014, N=73			
<i>Applying specific corporate strategies in response?</i>	<i>Yes</i>	32,6%	6,7%%
	<i>No</i>	67,5%	93,3%
Chi square: 6,922, p<0,009, N=73			

		<i>Perceptions of specific effects of demographic change on the firm-level?</i>	
		<i>Yes</i>	<i>No</i>
<i>Developing corporate strategies in response?</i>	<i>Yes</i>	28,6%	4,2%
	<i>No</i>	71,4%	95,8%
Chi square: 5,877, p<0,015, N=73			
<i>Applying specific corporate strategies in response?</i>	<i>Yes</i>	26,5%	12,5%
	<i>No</i>	73,5%	87,5%
Chi square: 1,853, not significant, N=73			

Source: Interviews stage 1 (postal survey)

**Table 6: Key associations about approaches to deal with demographic change**

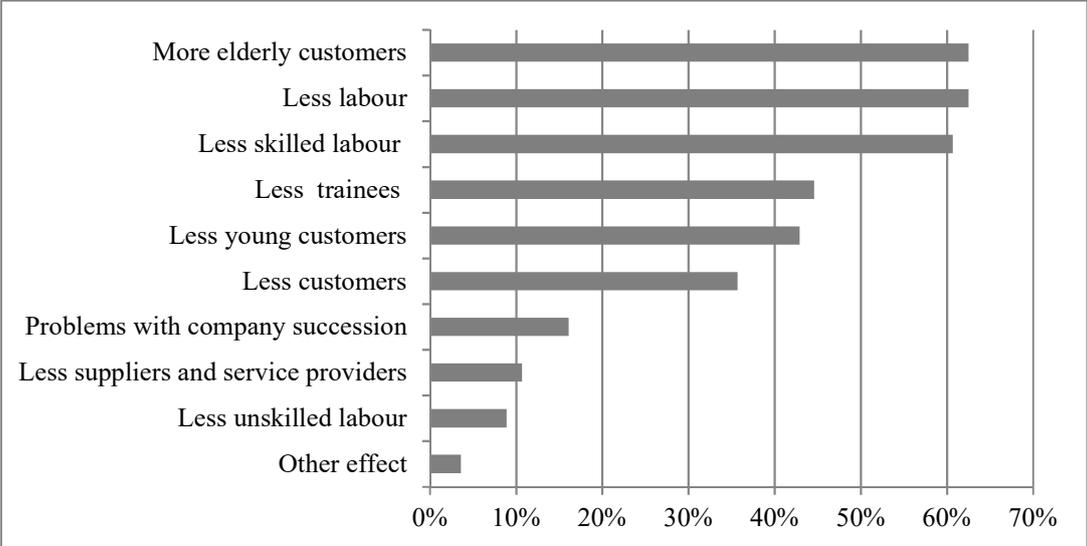
<i>Illustrative quotes for proactive strategic behaviour</i>	<i>Illustrative quotes for reactive strategic or non-strategic behaviour</i>
<p>“I cannot sit and wait ..., have to do some planning... and think about the changes to set the course” (<i>firm no. 8</i>)</p> <p>“We did not simply sit and wait until something happened, but consciously focused on the topic. ... We have asked ourselves: how will markets look like? How will they develop? How should we proceed then?” (<i>firm no. 9</i>)</p> <p>“We became aware of opportunities when we looked across the fence... We observed how markets change and where we will go.” (<i>firm no. 14</i>)</p> <p>“This can only be a kick-start. We have to think about enlarging our range of offers and we have to keep our ear to the demand. We also need to think how we will implement changes.” (<i>firm no. 14</i>)</p>	<p>“I am not gonna panick now because changes have not been dramatic. I live hand to mouth as a sole entrepreneur.” (<i>firm no. 15</i>)</p> <p>“We do not have a strategic planning approach. Short-term projections are sufficient. It is all about reacting for us.” (<i>firm no. 17</i>)</p> <p>“All of these are reactions to emerging problems. We are too small to take action. We are too much involved in daily operations. We cannot make plans and anticipate changes.” (<i>firm no. 11</i>)</p> <p>“I cannot but react. I am not able to proactively take steps although I should rather proceed this way.” (<i>firm no. 16</i>)</p>

Source: Interviews stage 2 (narrative interviews)

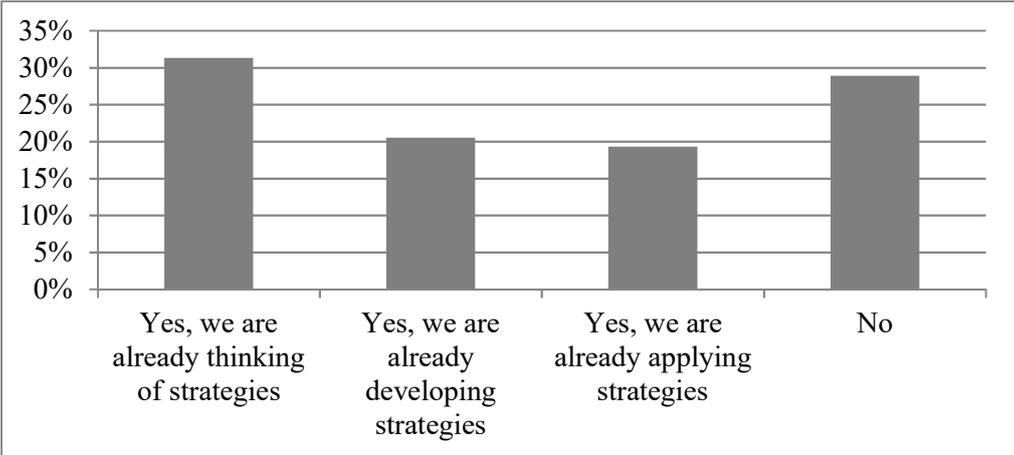
**Table 7: Specific adaptive strategies for local sales markets**

Adaption to elderly customers	55,2
Accessing new customer groups	53,4
Individualised products/services	51,7
New, age-specific products/services	48,3
Upgrading of products/services	46,6
Diversification of products/services	37,9
Business co-operation and networking	37,9
"Emotionalising" products/services	31,0
Investments in marketing and promotion	27,6
Market expansion (national markets)	24,1
Concentration on profitable markets	10,3
Closure of business units	10,3
Other strategies	8,6
Output reduction (quantity, frequency of products/services)	8,6
Closure of branches	6,9
Focusing on product delivery through networks	6,9
Output reduction (intensity, type of products/services)	5,2
Market expansion (exports)	3,4
Company closure	0,0

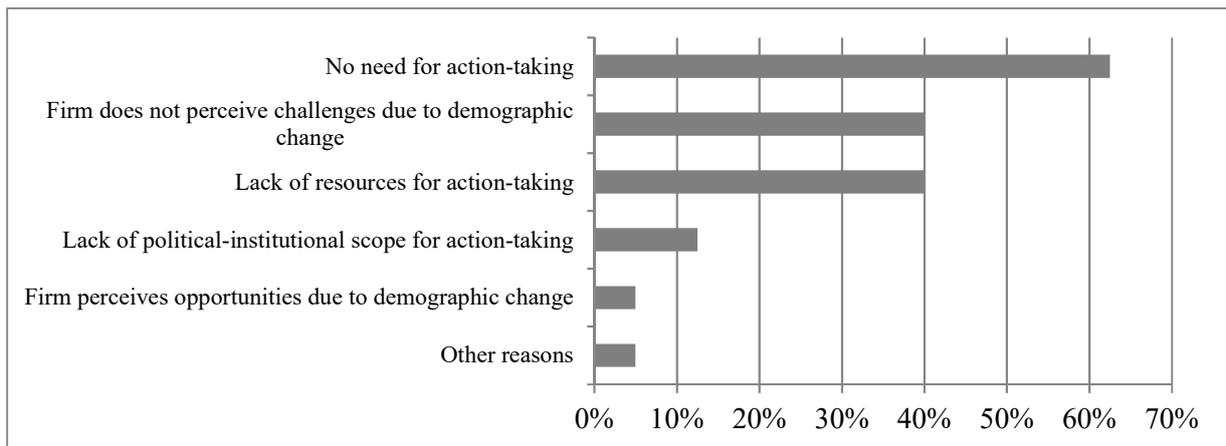
Source: Per cent, multiple responses were allowed;  
Interview stage 1, postal survey



**Figure 1: Firm-specific effects of demographic change  
(Multiple responses were allowed; Interview stage 1, postal survey)**



**Figure 2: Strategy-formation: Preparation, active involvement and rejection (n=81, Interview stage 1, postal survey)**



**Figure 3: Strategy-formation: Why firms do not develop strategies (Multiple responses were allowed; Interview stage 1, postal survey)**