

# ECONOMIC PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES (SMEs)

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**Abstract.** Our research in the field of SMEs include the concept of performance, problem that is different in comparison with large enterprises. Defining the concept is more importing in SMEs diagnose analysis because results should be judged in terms others than of efficiency and profit.

This paper analyses the concept of “economic performance” in terms of diagnose analysis in small and medium enterprises. Theoretical considerations are presented by defining the concept of dual representation in the form of economical results and personalized expectations of the owners. Paper present a specific mode of performance evaluation of SMEs, the main factors and the main indicators used in the evaluation process of these enterprises. Also are detailed the main evaluation criteria of the factors and some key aspects of their interpretation.

Conclusions refers to the need of differential treatment of diagnostic analyses to small and medium enterprises compared to large enterprises and expanding research toward other areas such as sociological, political or administrative.

**Keywords:** Performance, diagnose analysis, resources, organization, relationship system

## 1. Introduction

The activity of any company is determined by the economic performances of its organizational structures, determined by the way they perform the main functional process in the limits of awaited indicators. More than in large enterprises, in SMEs, performance is not just fulfilling some statistic indicators but also a sum of values determined by subjective factors related to the personality and aspirations of the entrepreneur and his environment. Determination of their value system and their determinant factors is the specific element of performance evaluation. The correctness of these depends to a large extent on the final results and chances of achieving their goals.

In the diagnose analysis of SMEs it is, as a primary objective, to define the “economic performance” concept by evaluating the influence of determinant factors, from both internal and external environment, on their own value system (figure 1).

If, to the internal environment level, performance is linked to effectiveness and efficiency of internal production processes, quality and control of business organization and management, to the external environment level, the organization's performance is assessed related to the economic situation or stage in the life cycle of the business and to the quality of the system built around the business (this last one strongly influenced small and medium enterprises).

The economic situation in which the business is presently defines the company's position in relation to the main market variables as a consequence of

the development level of the enterprise's products in relation to consumer demands. Positioning the company's activity in the market is the starting point in most diagnostic analysis of the company's performance.

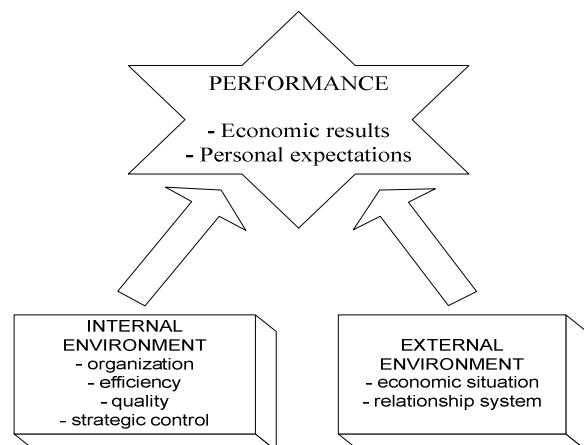


Figure 1. The economic performance of SMEs

## 2. Internal environmental factors

The internal environment of small and medium enterprise carries the strong imprint of the owner-manager. This is the personal expression of implementing the strategic plans of the company. This is determined by the level of professional training and accumulated knowledge (experience) in both the technical field and organizational management field.

At the internal environment level there are highlighted the first negative signals of the company's performance: decrease of production, sales and profits, reduce of salaries, damage of

working climate. These all claim the need for change. At this level are implemented also the first steps of change in order to recover or improve the performance after the diagnostic analysis.

In the diagnostic analysis there are considered four categories of internal environmental factors: organizational, efficiency, quality and strategic control.

### 2.1. Organizational factors

In SMEs level with limited resources, high economic performance can be achieved by simplifying and de-bureaucratization of the organizational structures and by raising the value of human creative potential. This way the internal organization concept passes to the procedural phase, which is de-personalized, specific to large enterprises and a phase whose primary role is the one of the individual and his ability to act in the interest of the company which is also his own. This

is done by raising the individual responsibility and commitment to the entire staff.

Simplification of the enterprise's organizational system means to abandon some formal procedures and to replace them by informal procedures of stimulating individual responsibility of the employees. The final effect is increased system' efficiency and reduce costs. Simplification also requires organizational structures that ensure priority development of structures that insure basic functions. The support functions are subordinated to them or being outsourced. This strategy reduces the number of departments and individuals at an optimal level related to the size of the enterprise and the level of business.

Table 1 provides an overview of organizational factors in SMEs, highlighting the performance indicators and how to improve them and negative effects of non-fulfillment of them [1].

Table 1. Organizational factors in SMEs

| Performance indicators                | Improving mode  | Negative effects of non-fulfillment  |
|---------------------------------------|---|--|
| Objective priority                    | Subdivisions organization in order to achieve primary objectives                        | Over or under-sizing of departments  |
| Unity in decisions                    | Focusing the decisions to owners level and operational departments                      | Multiple subordination, tensed working climate   |
| Individual responsibility             | Reduction of hierarchical links, increase of individual skills                          | Overlapping tasks, diluted responsibility  |
| Approaching owners to executive level | Reducing the number of hierarchical levels to the minimum necessary                     | Elongation of structural pyramid, heaviness of communication, decision-making rigidity             |
| Task interdependence                  | Concentration of decision, increased individual responsibility, eliminating duplication | High time consumption for tasks completion, high structural costs                                  |
| Permanent management                  | Clear delegation of responsibility in the absence of decision-making authority          | Management gaps in controlling and in the continuity of existing actions                           |
| Communications economy.               | Communicational structures by competent centers to filter information                   | Increased useless information traffic between departments, lower value use of valuable information |
| Consistency of job-person             | Selecting appropriate people according to tasks and job responsibilities                | Making inappropriate tasks, personal grievances  |
| Structural flexibility                | Compartmental and individual responsibility; collaboration between departments          | Hardening and aging of the structure; delayed and inappropriate reactions                          |
| Structural efficiency                 | Evaluation of profitability of each sub-division; structural unprofitable outsourcing   | Unjustified structural costs, low organizational profitability                                     |

### 2.2. Efficiency factors

The efficiency of the activity is the most important economical criterion for assessing the performance of an organization. It is an expression of resource consumption compared with the results. In addition, the competitive potential of a company results from the way the strategic objectives are harmonized with the available resources and how these resources are highlighted.

The efficiency is by its very nature a comparative concept that has no meaning except in

a competitive context. Internal efficiency of the enterprise is appreciated by comparing the level of some efficiency indicators to a referential that can be the level of competition, the planned level or the level realized at a certain moment in time.

For SMEs we evaluate the efficiency of three main categories of internal resources: financial, technological and human, in terms of criteria and indicators; an example is shown in Table 2.

Table 2. Efficiency determinant factors

| Resources     | Criteria                                  | Efficiency indicators   |
|---------------|---|---|
| FINANCIAL     | Differentiation from competition          | Production sold (turnover); Margin of production; Value added; Gross operating surplus                              |
|               | Funding capacity                          | Working Capital Fund (FR) working capital requirements (NFR); Self-financing capacity (CAF), liquidity and solvency |
|               | Satisfaction level of owners              | Net profit (dividend); rate of profit; rate of capital  |
| TECHNOLOGICAL | Closeness to the level of the competition | The total cost of production, level of fixed costs, margin trading; Breakeven                                       |
|               | Closeness to buyers requirements          | Number of products in the range, coverage dimensional level; level of quality                                       |
| HUMAN         | Size and structure                        | Number of employees, percent of administrative staff; the average skill level                                       |
|               | Behavior                                  | Time found coefficient; level fluctuation   |
|               | Efficiency                                | Labor productivity, the availability of equipment   |
|               | Competence                                | Knowledge, practical experience   |

**2.3. Quality factors**

In the diagnose analysis, the quality of a product or service is evaluated in terms of satisfaction provided to recipients in all three life

stages, namely: design, manufacturing and service or product recovery (figure 2).

Table 3 presents the main quality factors of processes and product life stages.

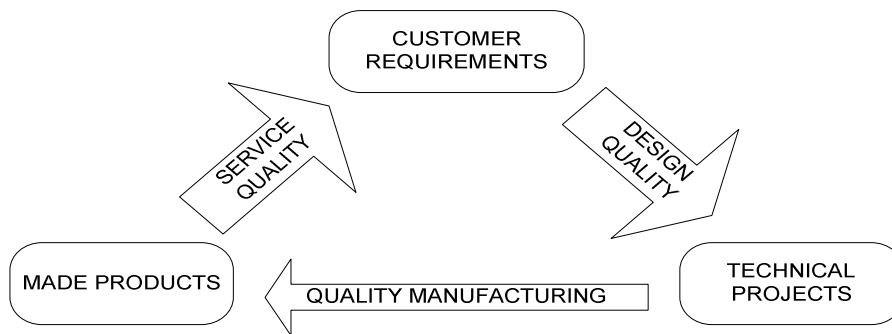


Figure 2. Production quality

Table 3. Quality determinant factors

| Life stage    | Process                                  | Quality determinant factors   |
|---------------|--|---|
| Design        | Quality design (expected values)         | Performances, aspect, accessibility for maintenance, assembly facilities, packing mode, cost design   |
| Manufacturing | Quality of production (effective values) | Technical performances, reliability, level of reject and waste products, environmental pollution, direct and indirect costs of manufacturing, quality class |
| Service       | Order fulfillment                        | Quality complaints from customers, how to handle urgent orders, the order processing time   |
|               | Distribution                             | Delivery time, the percent of fulfillment of delivered orders, distribution efficiency, logistics   |
|               | Post delivery services                   | Service time, warranty period   |

**2.4 Strategic control factors**

Strategic control in SMEs is less intense as in large companies because there are not involved specialized people and compartments. But it may be more efficient due to its concentration around people with strategic decision power. In this way the time of reaction to deviation from the planned strategic line is short. Strategic control in SMEs consist in successive measurements of perfor-

mance parameters of the activity followed by a strategic steering by corrective interventions on processes when deviations exceeded certain limits and revising or updating strategic plans when they no longer meet the original conditions.

The main strategic control factors in diagnosis of SMEs, by type of control, are summarized in Table 4.

Table 4. Strategic control determinant factors

| Type of control | Strategic control determinant factors   |
|-----------------|---|
| Post factum     | Financial (costs, incomes, profits), non financial (productivity, product quality, customer service, status of personnel)   |
| Anticipation    | Global environment (the overall rate of economic growth, inflation, unemployment), competitive environment (level of competition, access to suppliers, substitute products) |
| Implementation  | Indicators of profit (capital rates, growth rates, competitive rates, market share)   |

**3. External environment factors**

In the diagnose analysis of SMEs, business performance level in the external environment is determined by factors of economic climate and its relationship system. They can characterize the strategic objectives related to the quality and quantity of available resources.

**3.1. Economical climate factors**

The analysis of SMEs business economical climate brings to front a category of factors that define the market positioning and, although not necessary specific to them, have different importance in large enterprises. This way, if large companies are usually evaluated according to the technology and the product it offers, SMEs are assessed in terms of market information, portfolio of clients, technological level, prices and collateral business activities.

Evaluation of economic climate determinant factors is made by referring to competition, the main market variable. This way, the hierarchy may be determined based on the degree of deviation from the ideal company: the more informed, with the best product made with minimum cost, in terms of maximum productivity,

with the lowest sale price, the best organization management activities, research and development, distribution, promotion, etc.

Assessment of economic climate is important in establishing the overall framework of performance based on statistical developments of economic phenomena. But a simplistic approach and exclusive only on them is risky, with the threat of failure of components or complex connections with major effect on the evolution and development of business.

3.1.1. Market information level

SMEs market has a much better design and segregated character as a result of long and difficult steps in customer loyalty to the products offered. Attention of the entrepreneurs remains focused on the market throughout all business life both in market building phase and in the strengthening and development stages (they are different only by information on which are focused).

A summary of the sub-group determinants of assessment, on product development stage, is shown in figure3.

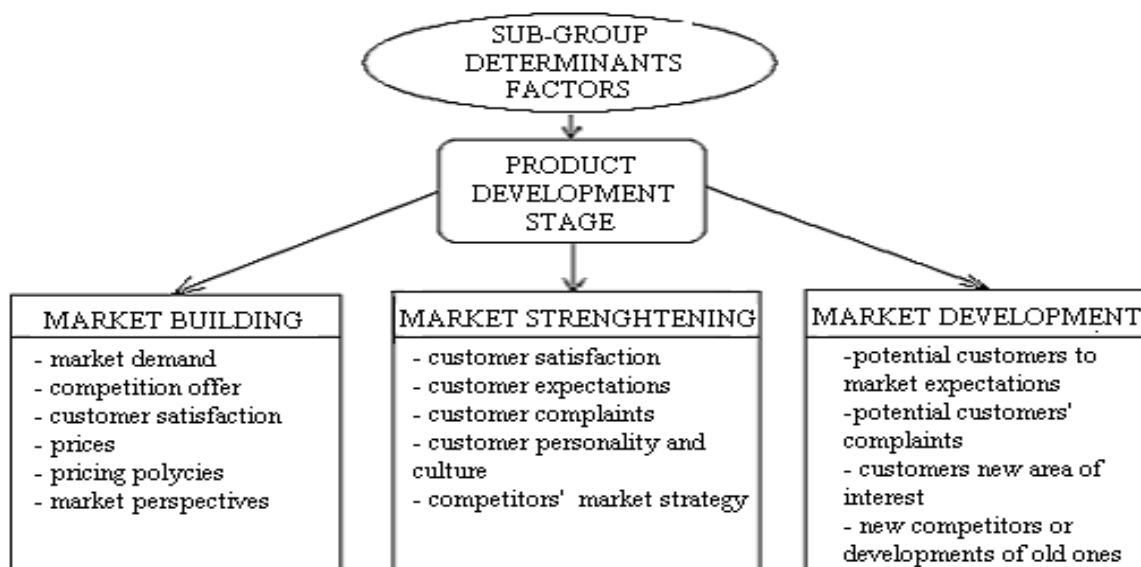


Figure 3. Market information factors

### 3.1.2. Portofolio of clients

Customers are the most important link in the economic chain; around them are most of SMEs activities. More than in large companies, that often depersonalize relationships with customers, the SMEs have with the clients an intense and continuous exchange of information that is concerned to meet their requirements. These enterprises have as strategic objective to connect their products to customers' visible system of values, therefore those that the clients are looking for in products on the market. SMEs market position is largely determined by their ability to harmonize their own value system to customers, better than the competition does. A portfolio of clients based on this harmonization has a greater stability in the face of competition's penetration tests [2].

A second element that provides stability and security to market position is the structure of portfolio. In this point of view a structure closer to „ABC-Pareto” curve, ensures financial balance and maximum security of the company. The more the stability of the portfolio grows, bigger the risk of damages gets minimum [3].

### 3.1.3. Technological level

Due to the major implications on the level of manufacturing costs and the value added in production, the technology enables business security assessment in a given period compared to the competition.

To SMEs the technological level is important but is not one of the business forces in competition with the large companies. However this may be an advantage on markets dominated by SMEs.

The technological level can be judged by the size and efficiency of research and development and technological innovation.

Determinant factors are: quality construction and technological solutions adopted by designers, the duration of processes, the renewal rate and the level of resources allocated to research and development field.

Assessment of technological level of manufacturing in terms of environmental impact indicators requires: identifying harmful environmental aspects, characterization negative influences on the enterprise and impact assessment (consumption norms, degree of pollution) [4].

### 3.1.4. Selling price level

Selling price is the main competitive variable of SMEs who frequently use it in the advantage of high flexibility for quick and favorable competitive position especially in competition with large enterprises. Therefore, in the assessing the sale price one should consider both quantitative and qualitative aspects of it (figure 4) [5].

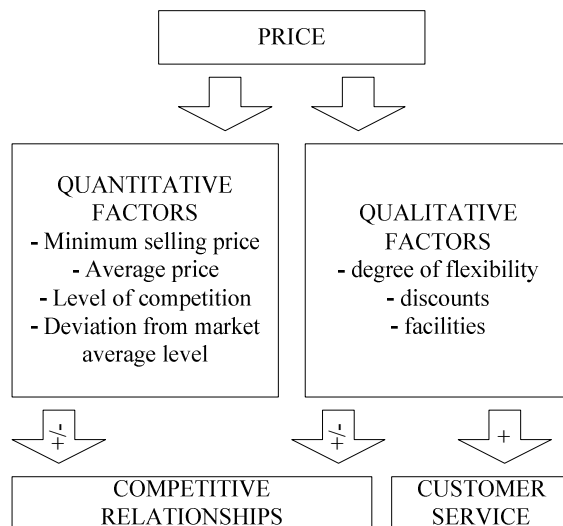


Figure 4. Selling price factors

While quantitative factors result by influence of production costs in price and lead to a definite position at a certain level of competition, the quality factors are the consequence of marketing policy and therefore they can only improve or worsen competitive capacity at the same price level. These factors are essential in strengthening the customer portfolio and market position conservation.

### 3.1.5. The level of collateral activities

Collateral activities are success factors for SMEs allowing them to overpass difficult times in their core business such as: market downturn, the seasonality of products, fluctuations in demand, changing the structure of production or technology. Although their level of development is lower than the core business, their existence reduces business risk and increases the safety as a result of diversification of activities. There are known cases in which the germs of collateral activities became core activities because of the scale and profitability demonstrated by them in the early stages.

Most frequently, collateral activities developed around the core activities are made by using available resources and certain skills that

the company has. There are also situations where collateral business activities are unrelated to core business, the only criterion for such activities as obtaining additional profits. Among these activities one can develop future core activities due to investments concentrated in the most profitable of them. The main collateral activities factors of SME are presented in figure 5.

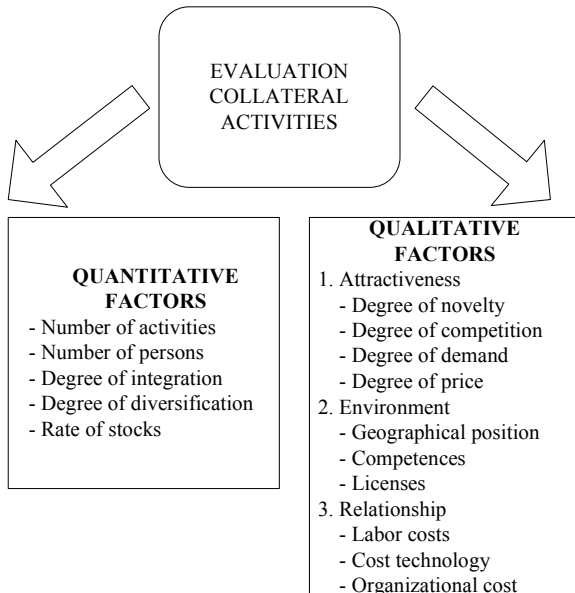


Figure 5. Collateral activities factors

### 3.2. Relationship system factors

SMEs relationship systems often have a orbital structure, in its center having the entrepreneurs and the collaborators of the business revolving around on different orbits closer or further away depending on their importance in the affairs of the company. The system includes bilateral relations with other organizations as continuous, timed, computerized and decentralized chains of mutual information, in order to improve business. More than large enterprises, SMEs depend on the relationship informational system as a result of limited resources that are compensated with information.

As a structure, SMEs relationship system is very well defined since the beginning of the business, around the main market players (customers, suppliers, competition), and the probability of a significant change is quite small. In time, the company aims to achieve efficient and stable structure by strengthening links within the system and by the possibly of establishment of new links, depending on the interests and needs through the combined effort of the entrepreneur and employees.

#### 3.2.1. Commercial relationship factors

At the commercial level representative are the relations with suppliers, customers, banking, employees etc. Their effects on the company are easy to grasp and is evident in short time after their onset. Commercial relationships are those which directly influence the market place of business products or services they produce in relation to competition and the factors that promote the maintenance and development of the market. They also allow the design of scenarios for the evolution of the organization in terms of profitability. They have the highest level of expansion being present even at the lower level structures, while in terms of intensity are often lower presented in the form of networking routines that do not require very high intensity of the enterprise structures. [6].

#### 3.2.2. Communication relation factors

The communication relations are made by collaboration and exchange of information with institutions from zone 2 of influence (public institutions, local and central administration, private collaborators). They target a far horizon of perspective of the business and are generated by the interest of the company at that moment and have a high intensity. Their effects on society are visible in time and are designed especially for strategic issues.

The main determinant factors at this level are: level of product market regulation, market access constraints, the degree of inter-networking business with the interest of public authorities, degree of inter-networking of the enterprise with other companies with competing interests, cooperative and associative character of business, enterprise integration level on labor market activity, extent of market especially outside the economic zones. Specificity of the factors is high at this level closely related to the type of business, its size, development level and financial strength of enterprise and entrepreneurs, because of high costs of setting up and maintaining relationships at this level.

#### 3.2.3. Mental – social factors of relations

The mental-social level Includes relations of the company with the external environment (habitat, population, etc.), leading the way in which the two coexist. Not to be neglected are the relations with civil society, environmental and animal protection agencies and any organizations

whose interests are or may intersect with the business. Even if the effects on society are random, the information at this level can lead to avoid serious conflicts with long-term effects on company image, its products or its employees. Here the mental and social relations are totally informal, are abstract and are much more personalized than the previous two levels, but their influence on business can be significant and sometimes decisive.

Due to the high influence on the business, mental and social relations are dealt with high intensity at peak strategic levels of the company and their frequency is lower as determined by the business impact on the external environment.

As a result of their strong customization is difficult to show a synthetic array of factors that influence these relationships. However, we can express some general factors to be considered in the construction of such systems throughout the business relationship such as: the impact level of the business on the environment, the possibility of generating negative externalities and the level of public and social interest of the business.

In SMEs as a result of much closer links between business and entrepreneurship, important roles at this level have the family relationships. The phenomenon is more pronounced in the case of family businesses where emotionally related persons are involved in lucrative activities having an economic purpose. If family ties seem to favour the construction of an effective networking, improper management of these links may lead to extremely negative effects on business activity running up to their closure.

#### 4. Conclusions

Particularities of diagnostic analyses are determined by the concepts of value and performance of each analysed company. Definition of a business performance is prerequisite to a correct diagnosis of its activity as a result of this concept influence on assessment and interpretation of results. Based on internal and external environment determinants factors of performance, evaluation criteria are established due diagnostic analyses.

To SMEs, performance factors of internal environment (organization, efficiency, quality and strategic control) are strongly influenced by subjective thinking of entrepreneur, which is determined by the level of training and accumulated knowledge (experience) in both technically and managing organizations.

The external environmental factors of performance to SMEs determine its level of adaptability to the external economic situation and to enterprise networking system that can influence the effectiveness of the work. The main external factors to SMEs are the level of the market informations, the portfolio of customers or activity level (product, technology, price, etc.) and regarding the networking system the factors are: business relationships, communication and mental-social relationships.

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