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Performance Management Model for SMEs

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Abstract:

One of the biggest challenges of all times for a company is to achieve performance. This term has a wide interpretation, from financial performance to innovation performance or social responsibility performance. Each company chooses its path to performance by defining its mission, strategic objectives and by improving its internal processes to achieve performance. There are plenty of tools for measuring the performance of a company, but SMEs need special tools for measuring and guidance through performance. This paper is proposing a new theoretical model for performance management for SMEs that will enable an up-to-date approach of managing performance in a small business. It is also presenting a number of factors that influences and limits the model.

1. Introduction

According to multiple researches there are three generations of performance management systems. The first generation of performance management systems was between 1980 and 1990 and has emerged as a need for new and more efficient methodologies and methods that accurately reflects the performance of a company. Therefore, there were developed new performance management systems known today as Balanced Scorecard, Performance Prism or Skandia's Navigator. The second generation of performance management systems is based on the correlation between flows and transformations. In this category new concepts were born such as Strategic Map, introduced by Norton and Kaplan, and Success and Risk Maps or IC-Navigator. The third generation of performance management systems is a mix between financial and non-financial resources and the way they interact with cash flow. (Rusaneanu, 2013) A research made by Aurel Brudan entitled "Rediscovering performance management: systems, learning and integration" performance management is divided into three categories: strategic management, operational management and individual management. The first one includes all activities and processes that a company uses to systematically coordinate and align resources and actions with the mission and the vision of the company. The operational management "although it is aligned with corporate strategy, its focus is more functional" (Brudan, 2010) and the individual perspective of performance management is a traditional one with the "longest evolution in history" (Brudan, 2010).

2. Strengths and Threats of Performance Management Systems

Nowadays, this third generation of performance management systems starts to have certain limitations that affect its performance. In a previous research made by me which was published in SEA-Practical Application of Science were analyzed from a SWOT perspective three of the main performance management systems, the Balanced Scorecard, the EFQM Excellence Model and the Performance Prism. There were found several weaknesses and threads on each of the performance management systems that raises certain concerns about the accuracy and applicability of the system in a company in our times. Also, for small businesses there are considerable limitations in applying this type of management system.

For the Balanced Scorecard there were found weaknesses regarding the lack of recommendations on how to improve strategies in order to overcome certain discrepancies. Also, the model is not considering the stakeholders or the risk management. As thread it was identified the fact that Balanced Scorecard is a general concept and can be misinterpreted by some employees or can incur resistance from them because may be considered as an additional burden of administrative work, or an indicator that their performance is not appreciated. On the other hand, there are plenty of strengths such as the alignment of the KPIs with the strategy at all levels of the company, the multi-level measures that allow managers to know what is needed to achieve strategic objectives. (Rusaneanu, 2013)

The EFQM Excellence Model is well known as a generic model that can be applied in any business field, no matter what the size of the company is or the sector in which the company operates. The main set of weaknesses and threads is related to the lack of detailed instructions on how to apply the criteria described in the model. Also, there are no information regarding the strategies or action plans that a company needs to adopt and apply in order to achieve great performance. On the other hand, the main advantage of this model is that it can be customized and applied on every company, regardless its size, sector or organizational culture.

The Performance Prism is an enhanced version of the Balanced Scorecard performance management system that captures also the stakeholder component in two new perspectives: Stakeholder satisfaction and Stakeholder contribution. From a thread and weaknesses

point of view, this performance management system doesn't offer detailed interpretation about the measures used for monitoring the performance of a company. Also, there is an insufficient link between actions and results. The main advantage of this performance system is the new stakeholder approach what captures the satisfaction and the contribution of this component to the performance of the company.

3. Performance management for SMEs

From a small business point of view, there are multiple criteria and limitations to take into consideration before developing and implementing a performance management system. The following research made by Mel Hudson, Andi Smart and Mike Bourne presents a set of requirements related to performance managements processes based on strategies which are focusing on SMEs. This concept of performance management based on strategies was developed from the criticism of traditional performance models. Traditional models are focused mostly on financial and historical data. To develop a performance management system is essential to identify the properties of an effective development process. Without it, there can be no practical value for the business. One of the objectives of this study is to identify the general principles of effective development and implementation processes that can be applied to performance management systems based on strategy. In order to be useful, a process should mention how an organization can be drawn to the implementation of the process, who could participate in the process and how it should be administered by the company. There are some key points in this process: the entry point, which necessarily involves an audit or assessment of existing performance management system to highlight deficient areas and indicate a way to improve those aspects; the participation, which includes the implication of the employees in this process; the procedures, which are harder to identify because they are depending of the type of process involved, but in order to ensure alignment of the processes with the strategy, it can be included the process of identification of the strategic objectives. Also, it is required a method for developing measurement indicators along with a procedure for maintaining the new performance management system. The last key point is the project management which includes four conditions for a smooth running of the process: the support from top management, the participation of all employees, clear and explicit objectives and a project management divided by time frames.

Hudson identified a number of critical characteristics of the process of performance measurement that any performance management system should have as follows:

- to be derived from strategy,
- to be clear and to have a precise purpose,
- relevant and easy to maintain,
- easy to understand and use,
- offers fast and relevant feedback,
- to have an interconnection between operational and strategy,
- to have a continuous growth stimulation. (Hudson, 2001)

| Development process requirements | Performance measure characteristics | Dimensions of performance |
|------------------------------------|-------------------------------------|---------------------------|
| Need evaluation/existing PM audit | Derived from strategy | Quality |
| Key user involvement | Clearly defined/explicit purpose | Flexibility |
| Strategic objective identification | Relevant and easy to maintain | Time |
| Performance measure development | Simple to understand and use | Finance |
| Periodic maintenance structure | Provide fast, accurate feedback | Customer |
| Top management support | Link operations to strategic goals | satisfaction |
| Full employee support | Stimulate continuous improvement | Human resources |
| Clear and explicit objectives | | |
| Set timescales | | |

Table 1: Typology for the evaluation of strategic PM development approaches (Hudson, 2001)

SMEs have certain advantages compared to large enterprises, such as low levels of bureaucracy, personalized and enhanced customer services, efficient internal communication, and shorter time to communicate certain problems. On the other hand, small businesses have some disadvantages compared to large businesses in the process of implementation of performance management systems. The main concern is related to the availability of resources, such as financial, human, infrastructure or knowledge-related resources. Small and medium enterprises have very limited resources when it comes to financial and human resources. Also, innovation and knowledge resource are very difficult to have and maintain with limited financial resources. Another disadvantage of a small business is related to the management of the company, most small companies are focused on short-term objectives rather than long-term ones. These characteristics that small businesses have provide premises for creating only performance management systems based on financial data or informal and unstructured data. Also, there are companies that don't realize the potential of a performance management system. Hudson conducted a study to see if some performance management systems designed for large companies can be also suitable for small ones. The conclusion of this study was that only a very small number of performance management systems may be suitable for the SME sector for two main reasons: limited resourced and short-term goals.

Another eloquent research in this area was "Enabling performance management in SMEs: a study into what SMEs need to measure and how they should manage performance" created by Hakon Fauske, Marco Busi and Erlend Alfnes which was based on interviews within small companies in order to identify the actual state of performance management systems.

| Area | Current state |
|---|---|
| KPIs | <ul style="list-style-type: none"> • Performance measurement are in most cases based on experience and common good sense, and not from a well defined methodology, • The performance indicators are not Key Performance Indicators, i.e. they are not linked to the overall business strategy, • The performance indicators are mainly focusing on finance and operations, and do not provide a coherent overview of all important areas of the company. |
| Performance Measurement/Management Practices Focal firm perspective | <ul style="list-style-type: none"> • The performance measurement efforts are limited to measuring operations and processes within the company, • The measurement are mostly used for control and not actively used in management. |
| Performance Measurement/Management Practices Supply chain perspective | <p>There is a general awareness of the importance and benefits of increasing visibility of the network performance; however models, guidelines or tools have not yet been defined for measuring and managing performance with partners.</p> <ul style="list-style-type: none"> • The only performance data shared is that required by customers or suppliers and not collaboratively designed. |
| Supporting technology | <p>Technological upgrading is in general necessary, but limited resources both of time and economy, call for simple and ready to use technology.</p> <ul style="list-style-type: none"> • The performance indicators are to a large extent manually gathered. |

Table 2: Current state of the performance management systems for SMEs (Fauske, 2008)

In the second part of the study, the companies involved in the survey responded to questions about the ideal state of using a performance management system. Thus, all companies have agreed that the use of performance indicators to set goals, to allocate and prioritize resources, to see the current state and to stimulate the future state, it is an important driver for competitiveness, both within the company and in the supply chain. Based on these discoveries were made several characteristics that must exist in any performance management system to be effective:

- transforming the strategy into operational performance indicators and strategic objectives within the company,
- monitoring, analyzing and controlling the performance of the company both individual and network level,
- Measuring and sharing key performance indicators within the network. System integration gives a company the opportunity to communicate and exchange data automatically,
- integrating and exchanging relevant and actual information within the network, reflecting all major areas of the enterprise and the supply chain: costs, time, quality, flexibility, precision, innovation and environment,
- Effective management of its performance using measurements not only for control but also for performance improvement.

Also, the companies involved in the survey made some observation regarding the infrastructure and software solutions for strategy-based performance management:

- To be based on a software platform, an accessible information system, easy to implement, use and maintain.
- ensuring coherence and aggregation of key performance indicators across different departments and levels within the company and within the network,
- creating a set of rules to calculate the indicators,
- Displaying the values and trends of the key performance indicators in an easy to use method: the information should be displayed using graphics or text.

4. Proposed Theoretical Model for a Performance Management System

The evolution of the competitive environment and the possibility to increase in size has led to organizational development in companies. If a performance management system focuses not only on the financial component, it can play an important role in supporting a rational approach for increasing complexity and improving the quality of SMEs. Also, the importance of continuous development has increased and has led to the establishment of performance management systems to support continuous improvement processes.

The innovation in information technology increases the opportunity to create a solid relationship between the performance management system and the information system of a company and to reorganize internal and external flows in an integrated approach. These new technologies help reduce the costs of implementation and use of a performance management system which is a very important aspect for SMEs due to their financial limitation of resources.

Based on case studies from the international literature and from the research made by me, a new theoretical model was created to accommodate the real needs of SMEs and to provide support for business processes involving fewer resources. The model is a pyramid consisting of five perspectives: customer perspective, financial perspective, processes perspective, environment perspective and the strategic component placed at the bottom of the pyramid which suggests that the strategy is the base for all perspective, in other words all perspectives are derived from the strategy component. A performance management model can be seen as a guide that contains suggestions about developing and implementing the strategy and methods that can be used to improve it in a continuous manner.

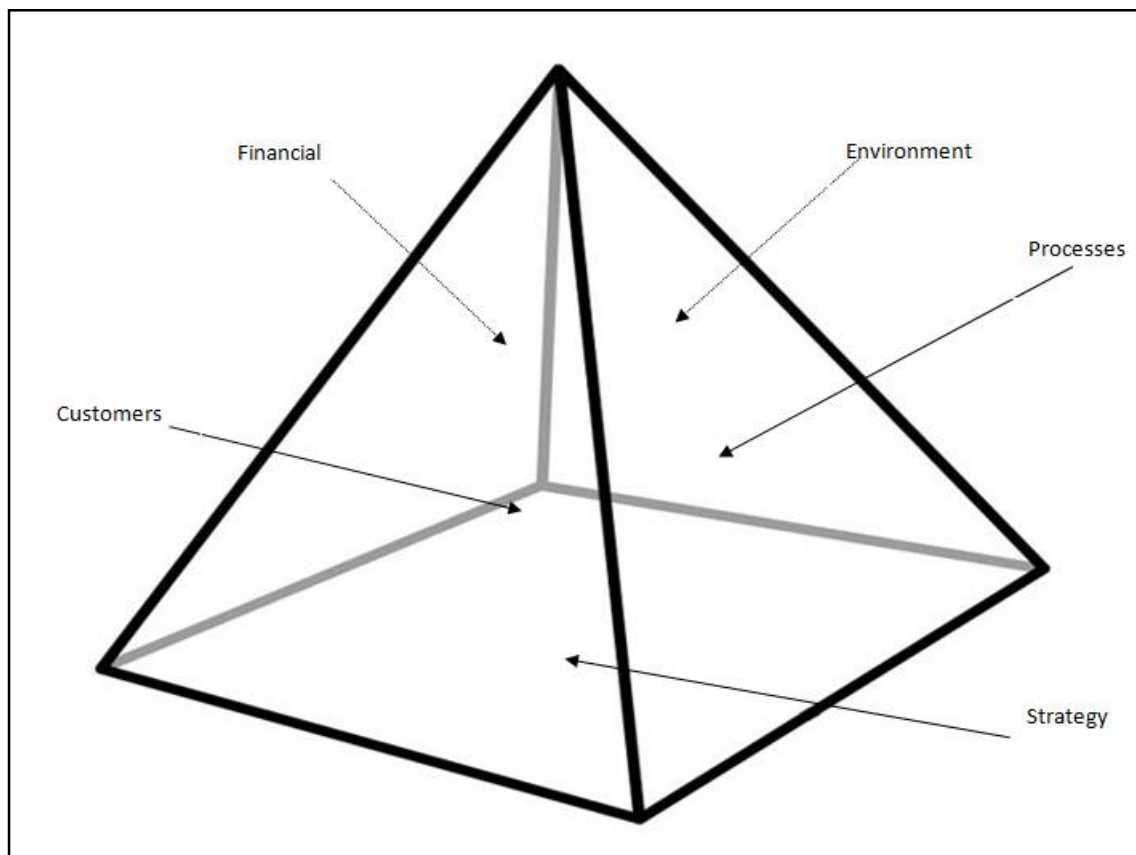


Figure 1: Theoretical model

Many performance management systems are focusing on strategic component and they are proposing that all performance indicators must be aligned with their strategies. Other models are focusing on stakeholders and their needs putting the strategy in the background. Therefore, a balance between these two main components is needed. Although the base of the pyramid depicts the strategic component, there is one side of the pyramid which is the stakeholder component. Therefore, both important aspects are taking into account for monitoring the performance of the company. We can look, for example, at the Balanced Scorecard that has a component in the Internal Processes perspective which is related to the shareholders. This component is based on the following question: "What types of internal processes should we excel at in order to satisfy our shareholders and customers?"

Any performance model can influence the behavior of a company and can affect the way in which the company implements its strategies. Therefore, this model should be designed and implemented in line with the company's business strategies and to link the strategies to the overall, department level or individual objectives. Any target must be connected to the chosen strategy. This poor alignment that it can be found in other traditional models is the main obstacle to successfully implement a performance management model. In SME case, the strategic component is the most important aspect of a performance model because in most SMEs this component is missing. A first step in implementing a performance management system is to define desired strategies for the company. Then, the relationship between the strategy, the strategic objective and operational activities must be made in an explicit way in order to maintain the focus on the strategy. The strategy and the performance management system can exist separately, but they need to be interconnected. Also, the purpose of the performance indicators from the model is to show if the company is on track in achieving strategic objectives.

The environment component of the model is related to the industry in which the company activates and targets performance indicators such as the level of stability on the market, the maturity of the company, its growth and also some market related indicators such as its competitors, its customers, its stakeholders and its profitability on the market.

The customer component is a mandatory perspective in any performance management model. The first model that introduced this component was Balanced Scorecard. The measurement of a company's performance using customer satisfaction is quite obvious today, but when the Balanced Scorecard was created this approach was considered an innovative idea. Unlike financial reporting, customer satisfaction related metrics can indicate a future performance. In case in which these metrics have good results then it can be stated that a company can have increased future earnings, but in case in which these metrics are negative then it can be stated that a company can expect a financial decay. The customer's perspective is an essential component for future predictions.

The financial perspective is a traditional component and it is necessary in any performance management system. Relevant and actual financial information is always useful for a company, but not sufficient in order to determine the overall performance of a company and to assure the alignment between strategies and actions.

The processes component is referring to the identification of critical processes which are influencing the achievement of strategic objectives. The objectives and measures of this perspective are formulated after setting financial goals and customer related goals. This flow allows companies to focus on certain process related metrics that are influencing also other metrics from different perspectives, such as customer or environment components. Basically, processes are impacting all perspectives within a performance model; therefore all processes must be aligned with the objectives from other performance components. Most companies which are using traditional performance models are focusing on improving existing processes, but once another performance system is adopted new objectives and processes will be defined in order to be linked to new strategies and strategic objectives that are part of the new implemented performance system. Nowadays, companies do not use only financial analysis as the main method of assessing performance, but are considering other methods of assessment. Thus, companies focus on improving quality, reducing manufacturing cycle time, increasing productivity, maximize shipments and reduce costs for existing processes. These processes must start from the innovative process which has become a very successful merger to increase performance of a SME. Therefore, innovation must be part and underpin a performance model specially designed for SMEs.

5. Conclusion and Limitations

SMEs are possessing special characteristics compared to other type of companies which can contribute to the occurrence of certain obstacles in the implementation and use of a performance management system. Among the factors that influence the implementation and use of a performance management system can be mentioned: limited resources, both financial and human; lack of well defined strategy, lack of understanding of the purpose of a performance management system. In case of small and medium enterprises the impact of implementing a performance management system is higher than in any other type of company. Also, SMEs are characterized having a poor strategic planning and less formalized decision-making processes that have only short-term impact. Lack of well-defined strategies and methodologies to support internal processes can lead to a short-term orientation and a reactive approach. Therefore, a proactive approach is needed to avert certain problems through the use of clear and relevant strategies and methodologies.

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