



The development of SME managerial practice for effective performance management

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Abstract

Purpose – This paper aims to investigate the gap between theory and practice in performance management in small and medium-sized enterprises (SMEs) and analyse it in the light of specific SME characteristics and needs, to identify how SMEs can develop their managerial practice for effective performance management.

Design/methodology/approach – The design of the study is based on literature review and multiple case studies. Combining both approaches and investigating a spectrum of 37 European SMEs through 232 semi-structured and face-to-face interviews with managers helped the authors to provide theoretical and empirical evidence to offer a more effective performance management process for SMEs.

Findings – The paper found that SMEs engage with a four-stage performance management process, although there are some gaps between their practice and the complete process as recommended in literature. SMEs seem to be more focussed on internal and short-term planning, whereas they pay less attention to long-term planning. The main challenge for making performance management practice more effective lies in an appropriate, balanced use of strategic and operational practices and relevant measures. Therefore, managerial activities such as vision, mission and values development, internal and external communication, change management and horizon scanning represent recommended areas for improvement.

Originality/value – The paper suggests a number of ways to improve the SME managerial practice to achieve a more balanced view of the whole performance process, which includes the mechanisms for the development and implementation of good practice in performance management.

Keywords Performance management process, Organisational performance, Managerial practice, Small to medium-sized enterprises

Paper type Case study



1. Introduction

Small and medium-sized enterprises (SMEs) are undoubtedly important to maintain strong economic growth; however, how to sustain their performance in the long term is a big challenge. Sustainable and consistent high performance is depicted by healthy

performance management practices. For SMEs, the adoption of advanced managerial practices in the main business processes is key to the successful improvement of their business performance and competitiveness (Cagliano *et al.*, 2001). However, it is well known from the literature that SMEs experience difficulties in adopting new and innovative managerial practices (Cagliano *et al.*, 2001). Therefore, there is a clear need to stimulate the development of managerial capability in SMEs considering the factors characterising these companies (Fuller-Love, 2006).

SMEs exhibit different managerial characteristics from larger organisations; as Storey (1986) points out, the small firm is not a scaled-down version of a large firm and we cannot simply look at the needs of SMEs by making small what was big. However, the literature provides limited examples of in-depth case-study based empirical research on performance management practice in the context of SMEs. Some authors made use of surveys (Sousa *et al.*, 2006; Wiesner *et al.* 2007; Cocca and Alberti, 2008), while others conducted single (Vichitdhanabadee *et al.*, 2009) or few case studies (Hudson *et al.*, 2001; Price and Erwee, 2006; Garengo and Bititci, 2007; Sharma and Bhagwat, 2007). Moreover, all of the authors mainly focused on limited aspects of performance management – for example operations management, manufacturing management, service management, technology management, strategic management – while none of the papers offers a broader and more comprehensive view of all the managerial activities that are part of performance management practice in SMEs.

In order to provide SMEs with useful advice and tailored recommendations on how to improve their performance management process, it is necessary to investigate thoroughly the status of their current performance management practice. To contribute to this research gap, this paper seeks to answer the following research question: what are the areas of improvement for the development of SME managerial practice in performance management?

In order to investigate the above broad research question, we should better understand the gap between theory and practice in performance management (PM) and the SME characteristics that may influence this gap. Consequently we have developed two further research questions:

- What are the main gaps between theory and practice in PM in SMEs?
- What are the SME characteristics that may influence these gaps?

To investigate the above questions, we will review the PM literature to identify firstly the managerial activities that constitute the performance management process and secondly the SME characteristics that might influence their managerial practices in performance management. Section 4 will provide an overview of the methodology adopted, while in section 5 the findings of case studies carried out in 37 European manufacturing SMEs will be presented and discussed in the light of the specialist literature reviewed. Finally, we will outline some concluding thoughts, and draw implications for theory and practice.

2. Conceptualising the performance management process

The importance of a better understanding of organisational performance as a process is that it shapes the way in which we manage and sustain it. This understanding in the field has changed a great deal over time. In the last 30 years, the field of organisational performance has developed from performance measurement – i.e. what to measure,

how to measure and how to report the results – to performance management – i.e. how to use the measures to manage the performance of the organisation (Amaratunga and Baldry, 2002; Neely, 2005; Folan and Browne, 2005; Bititci *et al.*, 2011). The literature on performance management is eclectic, diffused and confused (Smith and Goddard, 2002) due to the absence of any generally agreed-upon definition of “performance management” (Andersen *et al.*, 2006). The diversity of views on what constitutes performance management is reflected in the diverse disciplines that have sought to make a contribution to the topic (Smith and Goddard, 2002). Management researchers in areas as diverse as human resource management, operations management, strategy, marketing, finance, accounting, organisational behaviour, industrial economics, psychology, political science and operational research are all contributing to the field of performance management (Smith and Goddard, 2002; Franco-Santos *et al.*, 2007). Therefore, “performance management” is a phenomenon that is collectively “owned” by the management research community (Thorpe and Holloway, 2008) and a definitive “general theory” of performance management struggles to emerge (Smith and Goddard, 2002).

The purpose of this section is to identify the key activities included in the performance management process, by reviewing different definitions of performance management that exist in the literature. Management literature has been searched by using keywords such as “definition of performance management”, “performance management is defined”, “define performance management”, “performance management is”. Literature addressing only the public and non-profit sectors has been excluded because the objective of this paper is to focus on manufacturing companies in the “design-make-serve” value chain. The selected sources were then read thoroughly while searching for “performance management” definitions. Whilst reading, some cross-references that could be relevant for the enhanced specialist body of knowledge were identified and included in the review. Then, among all the definitions reviewed, a subset of 20 definitions was extracted according to the principles of assuring a good coverage of the disciplines involved and choosing the definitions that were more frequently cited and that provide an overview of the activities constituting the performance management process. Finally, in order to identify the activities that take place within a performance management process, the 20 definitions selected (see Table I) were content analysed.

The definitions extracted from the reviewed literature demonstrate the complexity of the analysed subject and provide different perspectives on the concept. The authors with a human resource background (Lansbury, 1988; Hartle, 1997; Armstrong, 2000, 2009; Pope, 2004; Aguinis, 2009) consider performance management as a way for managing people to increase the probability of achieving job-related success and place more emphasis on activities connected with improving behaviours, motivating, developing skills, training and rewarding. Definitions from the operations management field (Lebas, 1995; Bititci *et al.*, 1997; Busi and Bititci, 2006; Stiffler, 2006; Radnor and Barnes, 2007; Barnes and Radnor, 2008; Eckerson, 2010; Hagos and Pal, 2010; Parthiban and Goh, 2011) emphasise that performance measurement is an important part of the process, stressing the importance of all the activities connected with developing performance measures, KPIs and reporting. Authors in the strategy field (Otley, 1999; Verweire and van den Berghe, 2004; Moynihan, 2008) consider performance management as a process that helps an organisation to formulate,

Reference	Definition
Lansbury (1988)	“The process of identifying, evaluating and developing the work performance of employees in the organisation, so that the organisational goals and objectives are more effectively achieved, while at the same time benefiting employees in terms of recognition, receiving feedback, catering for work needs and offering career guidance”
Waldman (1994)	“Performance management is defined broadly here as processes oriented towards co-ordinating and enhancing work activities and outcomes within an organisational unit”
Lebas (1995)	“Performance management is a philosophy which is supported by performance measurement. [. . .] Performance management precedes and follows performance measurement, in a virtuous spiral and performance management creates the context for measurement. Thus any attempt at separating the two processes is bound to be vain”
Bititci <i>et al.</i> (1997)	“The performance management process is the process by which the company manages its performance in line with its corporate and functional strategies and objectives. The objective of this process is to provide a proactive closed loop control system, where the corporate and functional strategies are deployed to all business processes, activities, tasks and personnel, and feedback is obtained through the performance measurement system to enable appropriate management decisions. In essence, the performance management process defines how an organisation uses various systems to manage its performance. These systems include, but are not limited to: strategy development and review; management accounting; management by objectives; non-financial performance measures – informal; non-financial performance measures – formal; incentive/bonus scheme; personnel appraisal and review. At the heart of the performance management process, there is an information system which enables the closed loop deployment and feedback system. This information system is the performance measurement system, which should integrate all relevant information from the relevant systems”
Hartle (1997)	“A process for establishing a shared understanding about what is to be achieved, and how it is to be achieved, and an approach to managing people which increase the probability of achieving job-related success”
Otley (1999)	“It will be argued that there are five main sets of issues that need to be addressed in developing a framework for managing organisational performance that are represented as a set of questions. [. . .] The questions themselves appear to remain constant, but organisations need to continually develop new answers to them. This is because the context in which the organisation is set is constantly changing and new strategies need to be developed to cope with new operating environments. The questions are as follows: 1. What are the key objectives that are central to the organisation’s overall future success, and how does it go about evaluating its achievement for each of these objectives? 2. What strategies and plans has the organisation adopted and what are the processes and activities that it has decided will be required for it to successfully implement these? How does it assess and measure the performance of these activities? 3. What level of performance does the organisation need to achieve in each of the areas defined in the above two questions and how does it go about setting appropriate performance targets for them? 4. What rewards will managers (and other employees) gain by achieving these performance targets (or, conversely, what penalties will they suffer by failing to achieve them)? 5. What are the information flows (feedback and feed-forward loops) that are necessary to enable the organisation to learn from its experience) and to adapt its current behaviour in the light of that experience?”

(continued)

Table I.
Performance management definitions

Reference	Definition
Procurement Executives' Association (1999)	"Performance measurement information is used to effect positive change in organisational culture, systems and processes, by helping to set agreed-upon performance goals, allocating and prioritising resources, informing managers to either confirm or change current policy or programme directions to meet those goals, and sharing results of performance in pursuing those goals"
Armstrong (2000)	"Performance management is a strategic and integrated process that delivers sustained success to organisations by improving the performance of the people who work in them and by developing the capabilities of individual contributors and teams. Performance management is strategic in the sense that it is concerned with the broader issues facing a business if that business is to function effectively in its environment, and with the general direction in which the business intends to go to achieve its long-term goals. Performance management is integrated in two senses: 1) vertical integration, linking or aligning business, team and individual objectives with core competences; and 2) horizontal integration, linking different aspects of human resource management, especially organisational development, human resource development, and reward, so as to achieve a coherent approach to the management and development of people"
Pope (2004)	"An on-going managerial process that consists of planning performance, managing performance through observation and feedback (coaching), and evaluating performance"
Verweire and van den Berghe (2004)	"A process that helps an organisation to formulate, implement, and change its strategy in order to satisfy its stakeholders' needs. [...] Important aspects of performance management are setting performance goals, developing strategies, and translating them into concrete guidelines for action (i.e., making the strategies operational). Performance management is also about creating commitment and motivation to realise the proposed goals. Communication plays an important role in this process"
Busi and Bititci (2006)	"Managing performance involves a cycle of clarifying business goals and then agreeing individual objectives and standards of performance. The supporting performance management system would include the following key elements: a structured methodology to design the performance measurement system; a structured management process for using performance measurement information to help make decisions, set performance goals, allocate resources, inform management, and report success; a set of requirements specifications of the necessary electronic tools for data gathering, processing and analysis; theoretical guidelines on how to manage through measures (as [...] points out, performance management systems are used to apply the information and knowledge arising from performance measurement systems); and a review process to ensure that measures are constantly updated to reflect changes in strategy and/or market conditions"
Stiffler (2006)	"In order to effectively manage the performance of the organisation, an enterprise must: align the strategic objectives, plans and budgets of the various groups or departments that make up the organisation; measure historical performance with an orientation toward financial measures of organisational performance; report organisational performance, especially gaps between expected and actual performance; analyse what must change to optimize strategy and maintain organizational alignment. The closed-loop process of aligning, measuring, reporting and analysing is the essence of organisational performance management"

Table I.

(continued)

Reference	Definition
Radnor and Barnes (2007)	“Performance management, based on performance measures and reporting, results in improvements in behaviour, motivation and processes and promotes innovation”
Barnes and Radnor (2008)	“A performance management system is one which provides information on the matters of importance (communication), promotes appropriate behaviour (motivation), provides a mechanism for accountability and control (control) and creates a mechanism for intervention and learning (improvement)”
Moynihan (2008)	“A system that generates performance information through strategic planning and performance measurement routines and that connects this information to decision venues, where, ideally, the information influences a range of possible decisions”
Aguinis (2009)	“Performance management is a ‘continuous process of identifying, measuring, and developing the performance of individuals and teams and aligning performance with the strategic goals of the organisation”
Armstrong (2009)	“Performance management is a systematic process for improving organisational performance by developing the performance of individuals and teams. It is a means of getting better results by understanding and managing performance within an agreed framework of planned goals, standards and competency requirements. [...] Performance management is concerned with: aligning individual objectives to organisational objectives and encouraging individuals to uphold corporate core values; enabling expectation to be defined and agreed in terms of role responsibilities and accountabilities (expected to do), skills (expected to have) and behaviours (expected to be); providing opportunities for individuals to identify their own goals and develop their skills and competencies. [...] Performance management is a planned process of which the five primary elements are agreement, measurement, feedback, positive reinforcement and dialogue. It is concerned with measuring outcomes in the shape of delivered performance compared with expectations expressed as objectives (management by objectives). In this respect it focuses on targets, standards and performance measures or indicators. [...] It provides the setting for on-going dialogues about performance, which involves the joint and continuing review of achievements against objectives, requirements, plans. It is also concerned with inputs and values. The inputs are the knowledge, skills and behaviours required to produce the expected results. Development needs are identified by defining these requirements and assessing the extent to which the expected levels of performance have been achieved through the effective use of knowledge and skills and through appropriate behaviour that upholds core values. [...] Performance management focuses on future performance planning and improvement and personal development rather than on retrospective performance appraisal”
Eckerson (2010)	“Today, the industry seems to have settled on the generic term performance management to describe the combination of processes and technologies that help an organisation measure, monitor, and manage its business to optimise performance and achieve goals. More succinctly, performance management is a series of organisational processes and applications designed to optimise the execution of business strategy”
Hagos and Pal (2010)	“Corporate performance management consists of a set of management and analytic processes, supported by technology, that enable businesses to define strategic goals and then measure and manage performance against those goals. Core business performance management processes include financial planning, operational planning, consolidation and reporting, business modelling, analysis, and monitoring of key performance indicators linked to strategy”

(continued)

Table I.

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Reference	Definition
Parthiban and Goh (2011)	“Performance management both precedes and follows performance measurement. The effective conduct of PM is generally divided into two stages: (1) performance measurement; and (2) performance improvement. Performance improvement is the positive change which is brought about by process re-engineering, reflecting the concern of the customer. Process improvement identifies the redundant and missing performance measures, as well as identifies potential conflicts between performance measures and targets for each performance measure”

implement and change its goals and objectives and translate them into actions, while quality-focused definitions focus on the improvement of processes and performance which is brought about by process re-engineering.

Trying to accommodate and integrate the various perspectives and inputs provided by the different disciplines involved, performance management can be described as an iterative closed-loop process aimed to manage and improve individual and corporate performance through continuous adaptation to the changing operating environment. As it comes out from the definitions synthesised in Table I, the performance management process starts with strategy development, which requires the development of vision, mission and values and the definition of business goals and objectives both at the corporate and individual or team level (Bititci *et al.*, 1997; Otley, 1999; Procurement Executives’ Association, 1999; Verweire and van den Berghe, 2004; Busi and Bititci, 2006; Armstrong, 2009; Hagos and Pal, 2010). In order to deliver these objectives, specific business action plans should be developed (Procurement Executives’ Association, 1999; Armstrong, 2000; Pope, 2004; Verweire and van den Berghe, 2004; Busi and Bititci, 2006; Hagos and Pal, 2010). Resource requirements are considered both at a company level, in terms of financial and human resources, and at an individual level, in terms of training and development needs (Lansbury, 1988; Armstrong, 2000, 2009). Then strategy execution phase, which consists of implementing the planned actions and changes, takes place (Verweire and van den Berghe, 2004; Eckerson, 2010). In order to monitor the progress towards implementation of the strategy and the achievement of the objectives, a performance measurement and monitoring process needs to be in place (Lebas, 1995; Busi and Bititci, 2006; Stiffler, 2006; Radnor and Barnes, 2007; Moynihan, 2008; Parthiban and Goh, 2011). A set of key performance indicators (KPIs) should be developed, and both short and long-term targets for each measure needs to be planned (Otley, 1999; Busi and Bititci, 2006; Stiffler, 2006; Armstrong, 2009). The individual targets should be connected to individual responsibilities and aligned with the strategic goals in order to promote appropriate behaviours (Otley, 1999; Aguinis, 2009). The set of measures should be balanced in the sense that it should contain financial and non-financial measures, internal and external measures, and efficiency and effectiveness measures; it should include both measures which quantify what has been achieved (monitoring past performance/lagging KPIs) as well as measures that are used to help predict the future (planning future performance/leading KPIs) (Bourne *et al.*, 2003).

The performance, both at corporate and individual level, should be regularly checked and compared to the planned targets in order to inform managers to either

confirm or change current action plans to meet strategic goals and define improvement activities (Bititci *et al.*, 1997; Otley, 1999; Procurement Executives' Association, 1999). Performance information should be used to make decisions based on measures and to provide feedback to enable the organisation to learn from its past experience and adapt its current behaviour (Bititci *et al.*, 1997; Otley, 1999; Procurement Executives' Association, 1999; Barnes and Radnor, 2008; Moynihan, 2008). At an organisational level, this means challenging and reviewing current strategy in order to adapt to the changing business environment and emergent needs (Otley, 1999; Busi and Bititci, 2006; Stiffler, 2006; Parthiban and Goh, 2011). As the strategy changes, there is the need to review also the performance measures to keep them relevant and aligned to the company objectives (Busi and Bititci, 2006; Parthiban and Goh, 2011).

Appraisal and feedback at the individual level offer a mechanism for accountability and rewarding and are intended to motivate employees towards achieving goals and promote appropriate behaviours (Lansbury, 1988; Otley, 1999; Armstrong, 2000; Pope, 2004; Radnor and Barnes, 2007; Barnes and Radnor, 2008; Armstrong, 2009). Finally, communication plays an important role along the whole performance management process, and using appropriate and effective communication means (i.e. what to communicate and how) is particularly vital in order to create commitment and alignment (Otley, 1999; Procurement Executives' Association, 1999; Verweire and van den Berghe, 2004; Barnes and Radnor, 2008).

Having identified a set of activities that companies should do to manage performance, in the next section we will synthesise the characteristics that differentiate SMEs from larger companies in order to investigate how SME characteristics may influence the enactment of PM in SMEs.

3. Characteristics of SMEs influencing their managerial practices

A group of researchers, having examined and explored performance measurement from an SME perspective, concluded that the majority of performance measurement projects, although theoretically valid, do not take into consideration the fundamental differences of SMEs, thus resulting in a poor adoption of performance measurement practices in SMEs (Cook and Wolverton, 1995; Turner *et al.*, 2005; Garengo *et al.*, 2005; Hudson-Smith and Smith, 2007; Garengo and Bititci, 2007; Wiesner *et al.*, 2007). A key message that emerges from this literature is that, despite the availability of various models and methodologies supporting the implementation of performance measurement practices, their adoption in SMEs is still low, and it is necessary to identify approaches that meet the specific needs of these companies (Garengo *et al.*, 2005; Hudson-Smith and Smith, 2007). The above performance management definitions and their constituent activities do not consider company size. However, managing performance within the context of SMEs requires a deeper understanding of SME characteristics. Therefore, we have reviewed the literature and identified eight inter-related main characteristics influencing SME managerial practices.

3.1 Short-term priorities

The literature highlights that SMEs usually behave in a reactive manner; the level of strategic planning is poor and the decision-making processes are not formalised (Laverty, 2004; McAdam, 2000; O'Regan and Ghobadian, 2004a; Hudson-Smith and Smith, 2007). This behaviour is coupled with an absence of dedicated resources, thus

leaving SME managers juggling multiple short-term and long-term priorities at the same time. While they may have good intentions to set aside time to devote to strategic long-term activities, it is all too easy to let it slip when “urgent” day-to-day operational issues and customer needs take hold. SME managers immediately address to respond these “priorities”, whilst long-term strategic planning slips onto tomorrow’s to-do list (Jennings and Beaver, 1997).

3.2 Internal operational focus and lack of external orientation

Managerial practices in SMEs emerge mostly in response to internal operational needs, which present themselves mainly at the start-up of the business. Improvements are not planned, but rather are made only in response to contingent and emerging problems and often offer short-term solutions (Jennings and Beaver, 1997). The focus on technical aspects and operational issues seems to emerge from a conviction that the only real determining factor for competitive success is the technical excellence of the product and production processes. In these companies managerial tools and techniques are perceived as being of little benefit to the company. Besides, in SMEs planning is usually absent or limited only to the internal operational levels where performance is measured (Cagliano *et al.*, 2001). Internal orientation is associated with improving short-term performance, whereas external orientation is associated with improving long-term performance in SMEs (O’Regan and Ghobadian, 2004b). Successful SMEs are more externally oriented and they actively scan general economic and business conditions, technological trends and capabilities and regularly analyse their competitive position in the market (Daft *et al.*, 1988; Day and Schoemaker, 2005).

3.3 Tacit knowledge

In SMEs knowledge is mainly gained through experience, and it is often absorbed by means of tacit learning (Chaston *et al.*, 2001; Honig, 2001; Ward, 2004). A review carried out by Thorpe *et al.* (2005) recognises that in SMEs, knowledge is gained through the experience and associated tacit learning of specific individual. In contrast to the common existence of tacit knowledge in SMEs, some recent research highlights the importance of knowledge sharing explicitly to strengthen communication between customers and the organisation (Reychav and Weisberg, 2009). In spite of many researchers investigating the difficulties in moving from tacit to explicit knowledge (Darby and Zucker, 2003; Chaston *et al.*, 2001; Honig, 2001), some authors (Wong and Radcliffe, 2000; McAdam and Reid, 2001; Pillania, 2008) argue the need for the adoption of processes to minimise tacit knowledge by encouraging knowledge sharing across management functions to gain competitiveness and cost efficiency.

3.4 Looking for flexibility

Flexibility and responsiveness, opportunity creation and risk taking are common characteristics of SMEs (Margi and Philip, 1998; Aloulou and Fayolle, 2005). This is related to SMEs having processes that are not very structured or “engineered”. In large companies, it is a common practice to design and implement formalised processes to manage operational and managerial activities, whereas SMEs adopt less structured systems and processes when decision making and managing the whole business. This SME pattern of behaviour may be explained by the flexible nature of SMEs. However,

the lack of “codified knowledge” generates difficulties to transfer know-how quickly (Eriksen and Mikkelsen, 1996, p. 68), especially if the staff turnover is high.

3.5 *Poor managerial skills*

Many researchers underline that SMEs invest less in training and management development than large companies (Mangham and Silver, 1986; Curran *et al.*, 1996). In these companies management practices are closely linked to the individual’s skills and the characteristics of the entrepreneur. Usually they are multi-tasking while holding multiple roles and are in charge of both operational and strategic functions. However, they usually do not have the necessary time and heterogeneous skills, and usually neglect the managerial issues (Fuller-Love, 2006). Therefore, entrepreneurs rarely expand their business beyond the stage at which they can personally manage everything themselves (Gray, 2002) and the lack of management skills obstructs business growth and it contributes to the business failure. As Fuller-Love (2006) points out, in SMEs management development can be seen as improving the skills of managers rather than developing organisational capabilities.

3.6 *Entrepreneurial orientation*

SME managers might have good personal networks and relationships to gather information (Lipparini and Sobrero, 1994); however, these entrepreneurs often do not perceive the need for well formalised structures to manage performance (Hussein *et al.*, 1998; McAdam, 2000; Bourne, 2001; Bititci *et al.*, 2006). For many owner-managers, the business is basically an extension of their own ego and the decision making process is often influenced by the will to maintain their lifestyle rather than growing or improving the business (Banfield *et al.*, 1996). However, this entrepreneurial orientation should also be a positive trait. Filion (1996) studied the differences in managerial systems that are managed by professional managers and owner managers. They found that entrepreneurial managerial style could encourage engagement, idea generation, and opportunity seeking as well as organisational learning and process improvement.

3.7 *Command and control culture*

It seems that in SMEs, success is generally credited to the individual’s and the leader’s skills (usually the entrepreneur) rather than to any specific managerial processes or practices (Hudson-Smith and Smith, 2007). Many SMEs are owner-managed with entrepreneurs acting as dominant leaders who set the direction and run the business on the basis of their experience and common sense, which generally results in a command and control management style (Ates and Bititci, 2011).

3.8 *Limited resources*

Since SMEs have limited resources in the form of human resources, finances and time, they are often overloaded with short-term cash and payment problems (Thakur, 1999; Savioz and Blum, 2002; Qian and Li, 2003a, b; Martine, 2003; Hudson-Smith and Smith, 2007). Often, SMEs do not have the resources required to scan the environmental aspects of their business, carrying out market research and testing of products and services (Alon, 2004; Burke and Gaughran, 2006). As a result, this resource scarcity restricts SMEs’ capability around external orientation. The amount of the resources needed to develop a managerial system and managerial practices is proportionally

more onerous in SMEs than in big companies. Managers are occupying different positions at the same time – the entrepreneurs are in charge of both operational and managerial functions and they usually neglect the managerial activities. All of the staff are involved in the activities of managing daily work and have no extra time for additional activities like implementing a suitable managerial system or strategic planning (Hudson *et al.*, 2001).

In contrast to the above insights into SME characteristics, Cagliano *et al.* (2001) point out that there is a need for facilitating the adoption of advanced and more systematic management practices in SMEs to manage performance more effectively. The firm's ability to manage its processes, which primarily affects the way management operates when making decisions and exercising control, determines how well competitive advantage is sustained (Teece *et al.*, 1997; Dyer and Singh, 1998; Fuller-Love, 2006). SMEs seeking high levels of sustainable performance must also demonstrate the ability to carry out a purposeful set of systematic managerial practices in such a way that their full potential can be realised. However, the literature is falling short in explaining what those specific managerial practices are in order to achieve effective or satisfactory performance within SMEs, which we aim to address as a contribution to theory and practice in this paper.

In the previous section we identified, based on definitions of PM, a set of activities that companies should do to manage performance that are consistent with the activities identified by Bititci *et al.* (2011). These include, but are not limited to:

- developing employees;
- coordinating operations;
- developing and measuring financial and non-financial KPIs;
- personnel appraisals;
- developing and implementing strategy;
- providing feedback;
- change;
- resource allocation;
- coaching;
- action planning;
- communication; and
- motivation.

We also identified the characteristics that differentiate SMEs from larger companies. In order to answer our research questions, the next section will explore what SMEs do to manage performance and how this compares to SMEs' characteristics, and if so how managerial development in SMEs could be better supported.

4. Methodology

As recommended by Johnson *et al.* (2003), this study is taking an activity-based perspective as a theoretical basis that focuses on the detailed practices and activities that relate to performance outcomes for the business. We consider Davenport and

Short's (1990) definition of a process in order to understand the performance management process in SMEs:

... a process is a group of interconnected, purposeful set of activities and practices explaining actions of individuals and organisations in order to achieve an outcome.

Subsequently, given the specific characteristics affecting SME managerial practices listed above and the growing need for advanced and codified managerial practices, we adopt a multiple case study methodology to explore this topic in real life settings. Thus, the research design (Figure 1) adhered to those advocated by Eisenhardt (1989) to increase the reliability of retrospective case studies (e.g. interviews conducted following a protocol, informants selected from different organisational levels, all responses probed extensively).

4.1 Case study selection and data collection

Case studies were carried out in 37 SMEs across Europe, i.e. Scotland, Northern Ireland, Italy, Poland, Turkey, Germany, Malta and Czech Republic. The selection process aimed to give insights from a spectrum of SMEs in the manufacturing sector across Europe in order to explore the patterns of behaviour that emerged.

Using a research protocol across the research team allowed the researchers to gather data in a coherent and consistent way (Eisenhardt, 1989; Yin, 2003; Easterby-Smith *et al.*, 2004). Case study data were collected through 232 semi-structured face-to-face interviews with senior managers (i.e. MD/GM and direct reports) employed in the 37 SMEs involved in this study. These face-to-face interviews, conducted at multiple sites,

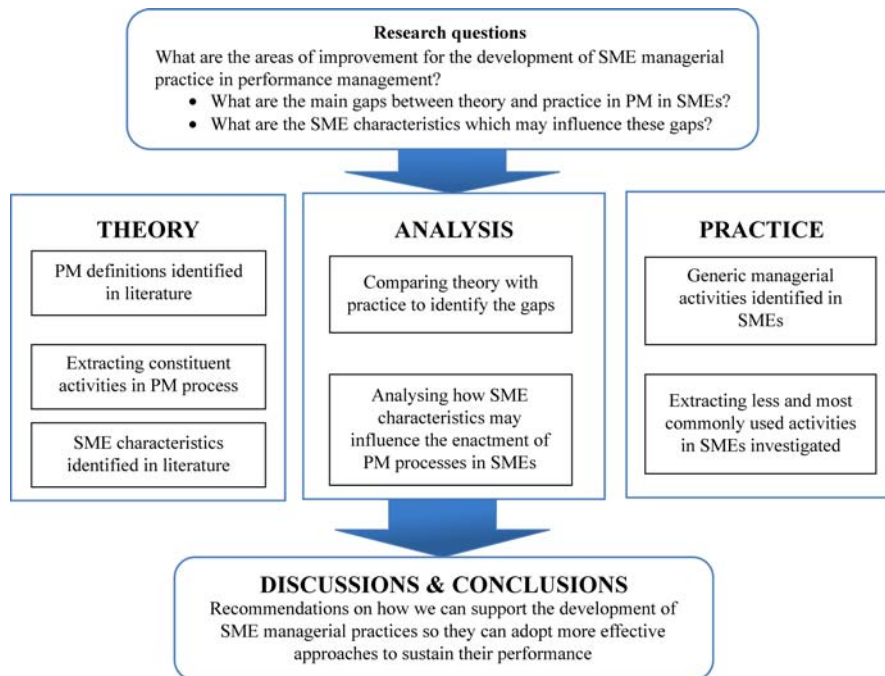


Figure 1. Research methodology and research process

lasted 1-1.5 hours each. Researchers toured the manufacturing plants and conducted follow-up interview sessions as necessary to ensure comparable information across all cases. The interviews were intended to allow free-flowing conversation between the manager and the researcher about their roles and responsibilities within the organisation and the practices they carried out in managing performance. When the free-flowing conversation ceased, the protocol provided a list of open “prompt” questions, such as:

- What do you think are the biggest challenges to the business over the next few years?
- What does success for the business look like?
- How do you manage your area of the business ongoing?
- What performance management practices are used?
- What sort of performance information is used? (link with success)
- How do you identify the performance measures?
- How often do you review performance measures for accuracy/appropriateness to current needs?
- How do you use these measures to help you to do your job?
- Where do the data come from?
- Who is the information communicated to and how?
- How do you improve performance of individuals? Staff appraisal, etc.?

Throughout the interviews the emphasis was on capturing what the managers did (i.e. the practices) and to what purpose they undertook these practices (i.e. the outcome).

Based on the conceptual framework as presented in Figure 2, we created a SPSS database that included binary coding (1 if the managerial practice was mentioned in the interview, or 0 if there was no mention of the managerial practice). The coded activities are, for example, Check KPIs, Check staff performance, Communicate change, Plan improvement activities and so on. We have used descriptive statistics (i.e. frequency of occurrence) and qualitative pattern searching (i.e. cognitive mapping) as data analysis techniques that lead the findings presented in the following section (Jick, 1979).

5. The main gaps between theory and practice and their relationship with SME characteristics

A great amount of qualitative data were analysed and used to study SME performance management practices in the companies investigated. The frequency of occurrence for individual practices is summarised in Figure 3 and the assessments are based on frequency of occurrence in coding of interview data.

PM is an ongoing, cyclical process. It should be a continuous process that is very much impacted by the operating environment with the sole purpose of facilitating various managerial practices and activities directed towards achieving the organisational goals and objectives (Kaplan and Norton, 1996). As a consequence it should evolve over time according to the changing needs of business (Bititci *et al.*, 2000; Garengo *et al.*, 2005), to support the firm in adapting to its competitive environment.

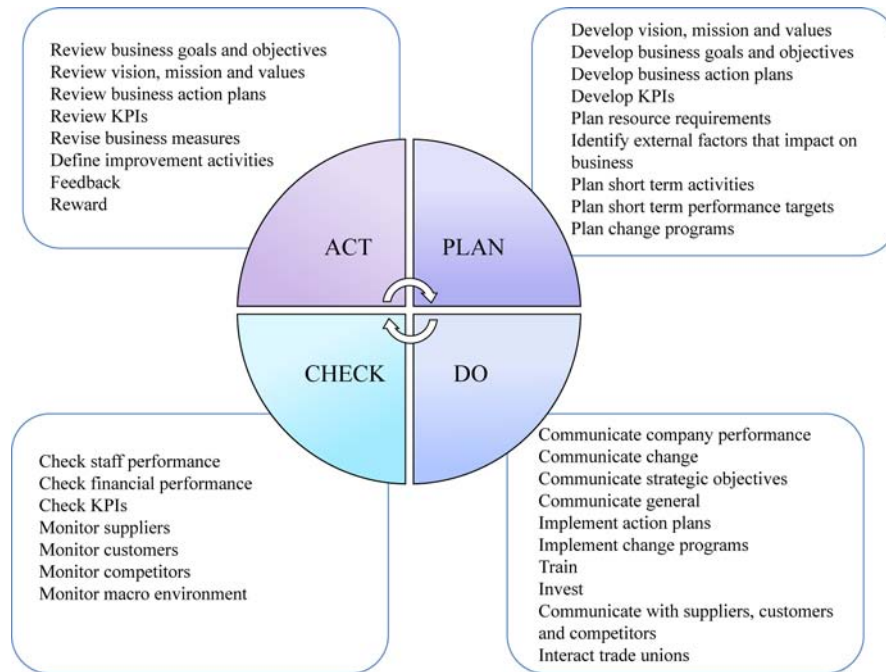


Figure 2.
Generic SME managerial activities within the performance management process

When we compare the SMEs activities identified in practice with the activities that emerged from theory, we find that the four phases of the PM process described in the literature exist in SMEs. In fact, all the activities constituting PM according to the literature are present in the list of activities cited by companies as part of their PM practice. However, it seems that the PM process as enacted in SMEs is incomplete and some key activities as recommended in the literature are not adequately emphasised. In fact, there are certain activities within the PM process that are carried out in less than half of the SMEs investigated. Figure 4 shows these gaps between the SME practices and the theory as well as the SME characteristics influencing these gaps.

As discussed before, it can be said that the core of any PM process is a combination of certain steps/phases, which do the work of planning, execution and review (i.e. PDCA cycle; Figure 4). The central idea behind any PM process is that the phases form the core of any PM process and the absence of even one of these phases will lead to the failure of the whole PM process. Our study showed that there is evidence that SMEs follow formally or informally all the steps in the PM process. Now we will discuss each stage in detail, highlighting the gaps.

5.1 "Plan" phase

This stage involves analysing the strategic direction of the company together with setting goals and objectives that should be based on both internal and external environmental analysis. Another important feature of this stage is that it also incorporates the planning for the whole PM process. How well this stage is completed will determine the effectiveness of the remainder of the PM process (Jennings and

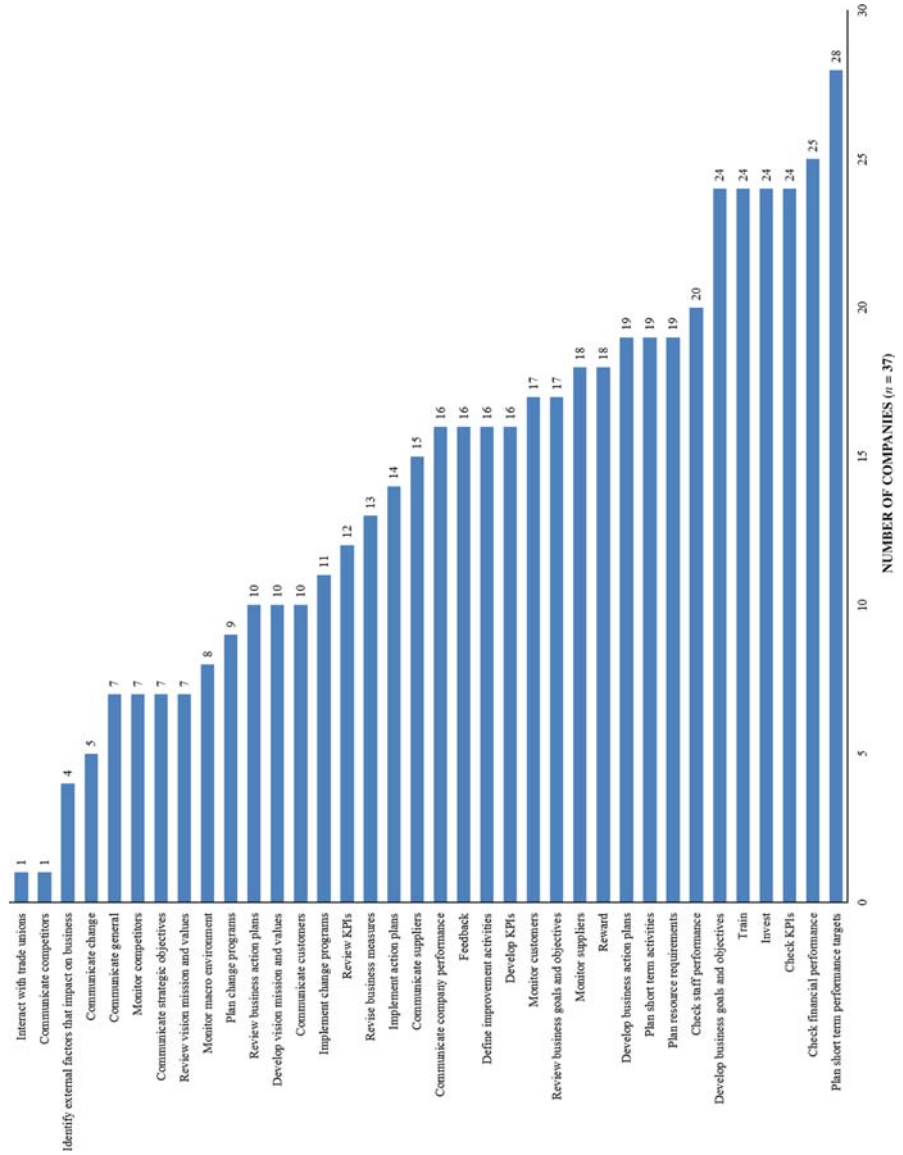


Figure 3. Performance management practices in the investigated SMEs

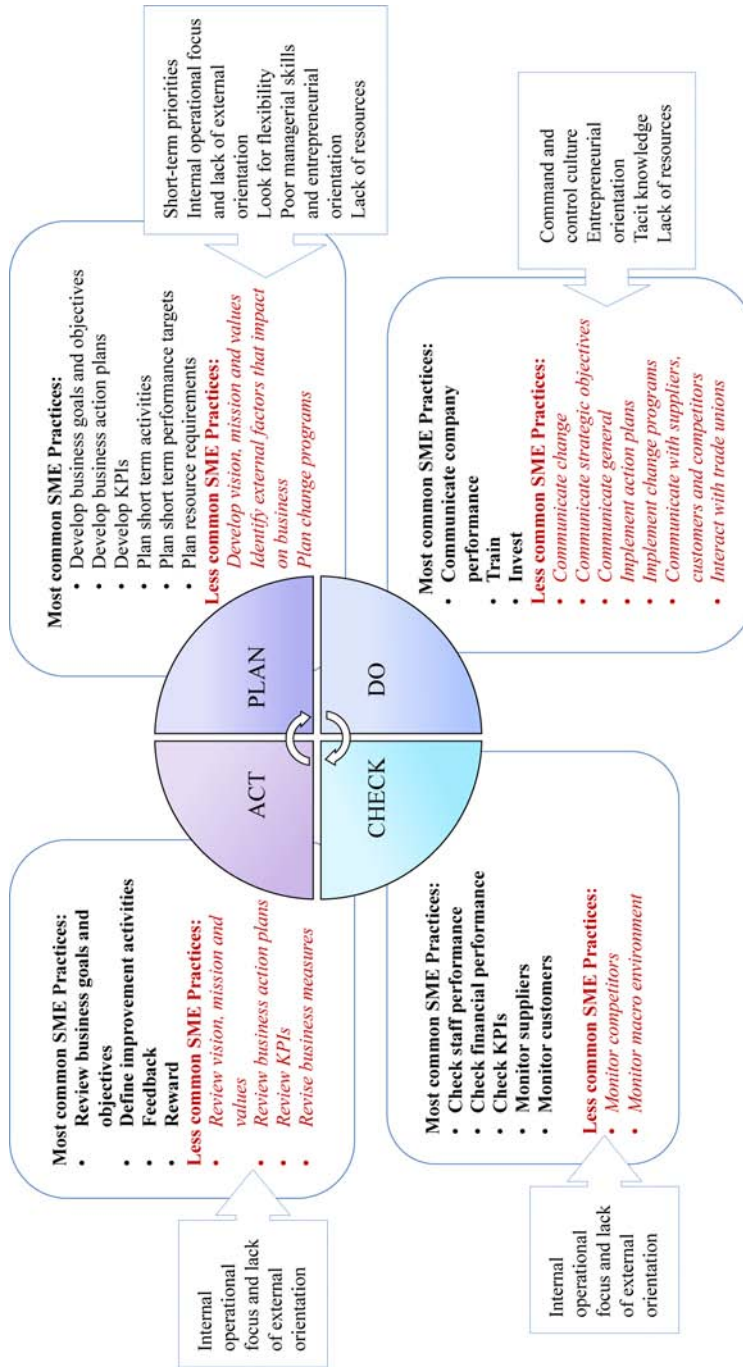


Figure 4. The gaps between theory and practice in PM and their relationship with SME characteristics

Beaver, 1997; Simons, 2000). Notwithstanding the relevance of this phase, we have found that SMEs put less emphasis on setting high-level vision, mission and values, and on horizon scanning as well as planning for required change projects.

The empirical evidence is consistent with the literature summarised in the previous paragraph. "Short-term priorities" and "look for flexibility" are key SME characteristics and they obstruct the development of effective mission vision and values. The focus on short-term priorities leads to short term-vision in SMEs that generates a managerial control disconnected with company strategies (Brouthers *et al.*, 1998). Planning activities are perceived by entrepreneurs as cause of bureaucratisation and an obstacle to the flexibility of SMEs, particularly if they are formalised using managerial systems (Hussein *et al.*, 1998; McAdam, 2000). Technical excellence in products and operational processes is often perceived as the only critical factor in SMEs and, consequently, all the efforts are on internal operational activities at the expense of the analysis of external factors affecting the business. However, as suggested by O'Regan and Ghobadian (2004b), internal orientation leads to short-term performance, and external orientation to long-term performance.

It is largely accepted that SMEs are burdened with an entrepreneurial orientation, where performance measures are considered as constraints to change (Jennings and Beaver, 1997; Ghobadian and Gallear, 1997; Brouthers *et al.*, 1998; McAdam, 2000; Jarvis *et al.*, 2000; Franco and Bourne, 2003; Fuller-Love, 2006; Garengo, 2009). As the literature underlines, SME managers and entrepreneurs do not have enough skills to manage strategic functions, thus obstructing their managerial development (Fuller-Love, 2006; Gray, 2002).

Based on the gaps between SME practices and the expert literature, we recommend that the external operating environment should be scanned regularly to identify and monitor factors that may have an impact on SME businesses (Porter, 1985; Daft *et al.*, 1988; Camillus, 1996; Choo, 1999; Day and Schoemaker, 2005; Martin *et al.*, 2009). External orientation should be implemented through effective internal/external communication plans. Regular and appropriate cross-functional communication of change projects, strategic objectives, performance results and their implications should be established by using a variety of channels to reach all stakeholders. This integrated approach will also help to motivate and enable the organisation's members to develop a common understanding and to work towards common goals (Kotter and Cohen, 2002; Scholes, 2005; Zhang *et al.*, 2006).

5.2 "Do" phase

A sound knowledge of the SME's operational environment, strategic objectives, its strengths and weaknesses are prerequisite for this stage, and these requirements should be fully taken care of in the planning stage. Because of the ever-changing operating environment, planning for PM and executing the plans are a continuous process that involves continuous communication with stakeholders. This communication acts as an early warning signal to update plans in a timely manner so as not to jeopardise targeted performance results.

The literature suggests that high performing SMEs generally use some form of internal customer/employee and supplier networks, have very open communication systems, have company-wide discussions of customer needs and problems, have cross-functional meetings, have monthly meetings with the entire company, and set up

performance measurement systems that are designed to initiate and reward market-oriented behaviours among employees (Martin *et al.*, 2009). However, effective communications in SMEs can be obstructed by tacit knowledge, i.e. in SMEs knowledge is mainly gained through experiential learning and it is often absorbed by means of tacit knowledge without any formal communication process (Chaston *et al.*, 2001; Honig, 2001; Ward, 2004).

For example, more than half of the SMEs investigated in this study demonstrated that their PM practices were lacking effective management of communications with internal and external stakeholders. One manager said that:

... the main challenge we have is providing channels of communication to prevent technical decisions and the progress of our projects to be interpreted personally. We don't have any visual display of performance in the factory and the general consensus is that it doesn't lead to higher motivation among the workers. Our workers are used to being told to have a job completed within a set period of time and for the most part this is achieved [...] communication across our company is more hit-and-miss, often there is confusion and tasks are repeated unnecessarily. The priorities are not clear regarding finishing an existing project or beginning work on new orders.

Similarly, regular wide-ranging interaction, both formal and informal, with current or potential customers and suppliers should be established as appropriate (Macpherson *et al.*, 2004; Martin *et al.*, 2009). There should also be controlled interaction with competitors and trade unions where it benefits the business, e.g. collaborative lobbying of government, avoiding trade union activity, memberships in trade organisations (Lavie, 2006; Teece, 2007).

The empirical data confirm that the traditional command and control management style still affects many SMEs, as a result adversely affecting their performance management practices. As is commonly seen in hierarchical and command and control organisations, centralisation of control is managed top-down without any standard process (Davenport, 1998), thus obstructing SME managerial growth. Also, poor communication of change initiatives and strategic objectives to stakeholders hinders operational effectiveness. The absence of communication of strategy is consistent with SMEs' internal operational focus (Tallon *et al.*, 2000). This behaviour is also reinforced by facing financial and human capital constraints that limit SMEs' ability to manage change. Also, the managers of some SMEs are risk-averse, especially as their companies mature; they become unwilling to introduce major changes because of preferred life style and family considerations (Gray, 2002).

5.3 "Check" phase

This stage involves qualitative and quantitative checking, monitoring and evaluations of the results of the PM execution. It is this stage that gives us a real understanding of how firms are performing against set objectives. KPIs should give a clear indication of progress towards achieving goals and objectives and should help to identify the priority areas that require immediate attention. This stage should cover checking a balanced set of KPIs that are both internally and externally facing and not only based on financial performance (Bititci *et al.*, 1997). For example, Ledwith and O'Dwyer (2009) highlight that SMEs should keep a closer eye on their competitors to improve their understanding of what competitors are offering, why customers do or do not buy

competitors' products, how they attract customers and how satisfied customers are with competitors' products.

Managerial practices such as checking KPIs and monitoring suppliers and customers have no meaning if they are not closely linked with a systematic monitoring of competitors and the macro environment. As the literature points out, the success of SMEs in today's turbulent markets depends largely on their ability to engage in environmental scanning activities in order to understand the behaviour of external stakeholders and trends (Beal, 2000; Qiu, 2008).

5.4 "Act" phase

The PM process phases as discussed above provide a well-defined path for an effective PM process in SMEs. In the final stage, followed by reviewing progress and KPI results, priority actions should be acted upon. The required corrective actions and improvement initiatives should be in place. In the SMEs investigated, we have found that KPI results are not used effectively to review and update the strategy, vision and mission of the company. For example, a manager highlighted that:

... we collect only financial information using our balance sheet. This information is used by our General Manager to monitor the profitability and the cash flow. Profitability is checked monthly but it is rarely used to change operational activities or business strategy.

Consequently, our findings confirm the tendency of SMEs to dedicate most of their attention to financial and operational activities within the PM process with the expectation of gaining short-term financial benefits. They often neglect external and internal communications, identifying and scanning external factors that may affect their business.

6. Conclusions

The increasing significance of SMEs for macro-economic stability, coupled with growing interest in improving short- and long-term performance, provides the ideal opportunity to investigate good practices within the PM in a SME context.

This research study confirms the need for more effective performance management based on SME practices and competencies that are influenced by their characteristics. SMEs seem to be more focussed on internal and short-term planning, whereas they spend less effort in possessing a long-term view on internal and external issues, such as communication, competition, sustainable competitive advantage, strategic market positioning and horizon scanning. SME managers should become more conscious that development on the path to short-term performance does not lend itself simply to changing at a later stage to the long-term path.

In order to support the development of managerial practices to improve organisational performance, we have identified some key areas of intervention for SME support agencies, advisors and consultants. Planning seems to be the most crucial phase of the identified closed-loop process. SMEs show difficulties in developing effective mission, vision and values, and most of them have never formalised their strategies. However, reference frameworks available in the literature for the implementation of a performance management system are based on a top-down approach, i.e. they establish performance measures starting from the identification and formalisation of the company's mission and vision (Cook and Wolverton, 1995; Hudson

et al., 2001; Garengo *et al.*, 2005; Turner *et al.*, 2005; Hudson-Smith and Smith, 2007; Wiesner *et al.*, 2007) without considering that SMEs have difficulties in managing concepts such as mission and vision. To support the development of managerial practices first of all, we should support SMEs to unveil their strategy without forcing SMEs to adopt the same complex methodologies used by large organisations, but proposing an approach that complies with characteristics and managerial culture of SMEs. The literature is developing in this direction; see, for example, the bottom-up approach proposed by Garengo and Biazzo (2012) to guide entrepreneurs and managers to unveil mission vision and strategy. However, further research should be carried out to develop an SME-friendly, visual strategic framework for guidance.

A second key barrier that SMEs should tackle to develop their managerial practice is the difficulty in managing the internal and external communication process. How can firms develop their performance practices without communicating with employees, customers and suppliers? It is clear that this is an internal contradiction that it is sometimes determined by distorted performance management practices, i.e. the collection of information to blame employees for negative performance, instead of improving the overall company performance. This also means to tackling the traditional command and control management style. There is a clear need to reinvent the management style in SMEs to move towards empowered and information-based organisations, similar to the recommendations made by Gary Hamel (2009). However, given the large diffusion of command and control approach in SMEs and the difficulty in changing that behaviour in the short term, the entrepreneur's commitment to the continuous development of managerial practices becomes crucial.

Thirdly, special attention should be given to the planning and communication of internal and external change initiatives. If top management does not pay attention to managing change effectively, the PM process will inevitably be affected. The main challenge is that critical change steps, particularly the soft aspects of change, are omitted. SMEs should take a more strategic and long-term view of change rather than seeing it as project management only. Changes should be driven proactively rather than waiting until change is imposed by external forces such as customer complaints and changes in legislation (Gray, 2002; Burnes, 2004; Ates and Bititci, 2011).

It is essential to note that the suggestions presented in this paper are intended to be neither exhaustive nor absolute. Rather, they are offered in an attempt to stimulate thought and discussion regarding a past and emerging body of research on the organisational development and performance management of SMEs. Since the main limitation of this study is the small size of longitudinal samples involved, a first direction of future research should be the investigation of a smaller sample of SMEs in more detail over a period of time in order to be able to understand how SMEs can overcome the barriers arising from their context to be able to implement a complete, effective performance management process.

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