PERFORMANCE MEASUREMENT SYSTEM AND MARKET ORIENTATION OF SMES: PRELIMINARY QUALITATIVE STUDY

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Abstract

This paper presents the results of our preliminary qualitative study focused on performance measurement and reward systems of Czech SMEs and how these systems support market orientation of those companies. Based on in-depth interviews with managers of five companies we found out that marketing managers in SMEs tend to use "hard" indicators of company performance, whereas they ignore "soft" ones. Furthermore, the reward system used by SMEs supports their short-term orientation. Moreover, this study also points out that SMEs do not systematically monitor the activities of competition on the market and do not connect this information into neither short-term nor long-term company strategy. Last but not least, we found differences in objective setting between companies with and without a foreign mother company. Whereas companies with foreign mother company prepare their strategy and expected results in advance, companies without foreign mother company assess performance according to the last period. All of these findings denote that the level of market orientation of Czech companies is far from optimal, and that the performance measurement and reward systems do not support market orientation.

Key words: market orientation, performance measurement system, reward system, SMEs

JEL Classification: M 31

Introduction

Market orientation is defined as the ability of a company to systematically generate relevant information about the market, spread this information across all the company departments and use this information in decision making and subsequent behaviour (Kohli & Jaworski, 1990; Jaworski & Kohli, 1993). In other words, market orientation is the degree to which a company includes information about the market into its strategic planning, or how it is able to learn from its environment (Baker & Sinkula, 2005).

Relatively many studies proved that market orientation correlates strongly with profitability (e.g. Narver & Slater, 1990; Jaworski & Kohli, 1993; Baker & Sinkula, 2005). Positive relationship between market orientation and business performance was found across a whole range of market situations. This relationship was strong regardless on market and technology turbulence or competition intensity (Jaworski & Kohli, 1993). Market orientation implementation or enhancement should therefore be top priority for any company. The CEO should take responsibility for the whole process and the Chief Marketing Officer (CMO) or his/her deputy should act as the main coordinator (Karlíček, Novinský, & Tahal et al., 2014).

According to Jaworski and Kohli (1993) there are a few key determinants of market orientation. Among them there is the emphasis of top management on market orientation of the company, willingness of top management to accept risks, connectedness and understanding between company departments and also company performance measurement and reward system orientation.

The design of company reward system seemed to have the strongest impact on market orientation from the whole set of determinants in the study. Organisations that evaluate and administer rewards based on customer satisfaction and service levels are more likely to encourage the active generation and dissemination of market intelligence and responsiveness to market need (Pulendran, Speed, & Widing, 2000). On the contrary, if managers are primarily evaluated with respect to short-term profitability and sales, they may be likely to neglect the key market factors. The evaluation of employee performance through sales volume, short-term profitability and rate of return measures leads them to focus solely on these aspects of performance and to the exclusion of market factors such as customer satisfaction and service levels.

Reward system is perceived as the key instrument in shaping the behaviour of employees. Some studies proved the essentiality of marked-based reward system in achieving market orientation (Jaworski, 1988; Brown & Widing, 1994). Furthermore, these studies showed that this type of reward system significantly reduces role conflict and job ambiguity.

It is also important that company reward system as a market orientation determinant comprises also other determinants mentioned. If employees are rewarded with respect to their market sensitivity and responsiveness, emphasis of top management on market orientation is demonstrated; common (market-oriented) objectives align the individual company departments, etc.

The importance of appropriate measurement (and reward) system for marketing effectiveness was also mentioned in other studies. For example in a recent Teradata study (2013) among 1100 marketers from 19 European countries, short-term orientation was considered the biggest barrier for marketing effectiveness. Short-term orientation is also suggested by a study among 227 Czech marketing directors (Karlíček, Chytková, & Fischer, 2013). Only 14% of the respondents considered marketing department as the most influential in constituting the overall company strategy, whereas the most powerful department was the sales department according to the respondents (it was mentioned as the most powerful department by 55% of the respondents), followed by the financial department (mentioned by 22.5% of the respondents).

In reality, companies often measure marketing effectiveness on the basis of short-term profit, sales or market share. However, many key marketing activities do not have an immediate effect on the overall results of the company (Webster, 2005). In this environment managers incline towards sales mentality, ignoring long-term impact on customers (Webster, 2006).

1 Goal of the Study and Methodology

The goal of this study is to find out how Czech SMEs use performance management and reward system and how these systems relate to the market orientation of those companies. As was already mentioned, the design of company reward system has the key impact on market orientation (Jaworski & Kohli, 1993).

The study was realized in cooperation with the research agency Millward Brown in April 2015. It was based on in-depth interviews with managers of five Czech SMEs.[1] In three cases we interviewed marketing managers, in one case an owner and CEO in one person and in the last case an owner and financial manager in one person.

For better orientation we labelled the companies with letters (A-E). The following table summarizes the facts about the respondents and their companies.

[1] For determination of which companies are small or medium we used the definition of EU. Medium-sized companies are defined as companies with less than 250 employees, small companies as companies with less than 50 employees and micro companies as companies with less than 10 employees.

Tab. 1: Information about respondents and their companies

Company	Field	No of employees	Respondent	Reporting to foreign mother company
Company A	Services and consultancy (B2B)	60	Marketing manager	Yes
Company B	Information and technology services (B2B)	80	Marketing manager	No
Company C	Financial services (B2C and B2B)	40	Marketing manager	Yes
Company D	FMCG and HORECA (B2C and B2B)	120	CEO and owner	No
Company E	FMCG and HORECA (B2C)	25	Owner and financial manager	No

Source: authors

To examine gaps in company performance measurement with respect to market orientation we prepared a scenario which consisted of two main parts. The first part was focused on performance measurement system. Although there are many criteria, we were interested mainly in financial, market and sales performance indicators (e.g. ROA, ROE, EVA, market share, sales, revenues or number of customers).

The aim of the second part was to get the most information possible about aspects related to the market orientation, e.g. dissemination processes and information across departments, focus on competitors, reward system etc.

Each interview took approximately 60 minutes. At the beginning the interviewer introduced the research and asked respondents about some warm up topics, e.g. employee structure or how the company gains new customers. Afterwards, the interviewer moved to the following parts related to performance measurement system and market orientation.

2 Findings

The in-depth interviews revealed several gaps in performance measurement system and market orientation of the selected SMEs. We found out that management of the SMEs is interested only in “hard” indicators, whereas “soft” indicators are not used in any systematic manner. We also found that the reward system supports short-term orientation of the SMEs. Furthermore, the SMEs do not systematically monitor strategic steps of their competitors. Lastly, we discovered the differences in performance measurement system between Czech companies and companies reporting to the foreign mother company.

2.1 Management of the SMEs is interested only in "hard" indicators

The selected SMEs use different ways of assessing company performance as a whole. The main criterion was the change in EBITA or profit. However, these indicators were usually coupled with other indicators, considered secondary. Among them was revenue per client, revenue per employee, profit margin, number of clients, number of new clients, revenue growth and others.

None of the SMEs used "soft" indicators (such as customer satisfaction, customer loyalty or brand performance) as the overall company performance indicators. None of the SMEs even used market share which would enable them to compare with the competitors.

However, some of the SMEs are trying to work with profitability of particular clients or segments, which is visible from the following statements.

> "When I started, we were not evaluating how valuable the new clients are, so we were not effective and spent too much time on some of them." (Company C)

> "When we looked at revenue per customer in more detail we discovered that we are ineffective in takeaway orders." (Company E)

The information about company performance is regularly spread only to the top management and the managers responsible for sales. Others learn about the company performance in less detailed and less frequent manner, typically on scheduled quarterly or half-yearly meetings. One of the reasons declared were worries about leaks to competitors or media.

> "Our CEO is afraid to share all the information on company performance, since there was a case when it was leaked and got public the very next day." (Company B)

2.2 The rewarding system supports short-term orientation of the SMEs

Smaller and locally owned SMEs in our sample focus primarily on rewarding their salespeople based on the volume of sales and profit. It is either a percentage of what they sell (3 % to 5 %) or they get significant bonuses if they exceed their target. This can be some 150 % to 300 % compared to their basic salary.

> “This [simple reward system] leads to lower effectiveness, but it is not a problem for the growing company yet.” (Company C)

CEOs typically get part of the company profit as a whole, mostly on annual basis. Their bonuses are based on attained objectives and are not correlated to actual profits. Long-term projects or projects without immediate profit can be therefore perceived as less desirable.

> “We have a show-me-the-money culture. This means some of the longer projects are hard to sell to the foreign owners.” (Company A)

The profit-only motivation leads to the situation when sales personnel ignore some necessary pre-sale steps if they do not see immediate success (e.g. lack of follow-up to events).
Also the short-term oriented performance measurement system relates to this fact. However, larger companies and companies reporting to foreign mother company seem to have a more sophisticated system of performance, setting multiple targets, such as profit margin, profit / employees, new contacts etc. Nevertheless, those targets do not involve customer satisfaction.

The problem with rewarding top managers with a share of company profit is manifold. First of all, the actual profit is known only at the end of the year and therefore cannot work as a monthly motivator. Secondly, many companies try not to post any profit because of taxes. Thirdly, the profit is dependent on many decisions beyond top staff control, mostly new investments, technology replacements and repairs, government decisions etc.

Another difficulty with rewards based on revenue is that a lot of business is seasonal and the actual salary would hence be too volatile.

On the other hand, not all respondent companies reward their employees on the basis of revenues or profit.

> “We primarily try to motivate in a positive way, not to punish them for bad results, since this doesn’t work.” (Company D)

This strategy may be successful because it does not cause stressful environment in the company.

2.3 SMEs do not systematically monitor activities of the competitors

We found out that none of the companies actively and systematically monitors their competitors. Exceptionally they check on their competitors' offers and marketing activities or they search information about their biggest competitors from professional associations.

Competitors' moves are considered secondary to company's own needs, both in terms of products or performance. SMEs evaluated themselves not compared to competitors but to their own past performance.

Many companies try to look abroad for comparison and inspiration or for setting benchmarks for individual projects (launch of a new web page, product etc.)

> "For us it is much more interesting to look at what is going on in Berlin than in Prague." (Company D).

The sales departments sometimes acquire information about their competitors but they are not motivated to file it in a systematic manner. The reason is either low interest in competitors (no perceived need) or that this is of low importance. Another reason was mentioned by one of the managers interviewed.

> "There is little relevant data for company such as ours. If there was more, it would still be too expensive for us."

However, some of the respondents believed that low competition intelligence was a failure.

> "We are sometimes caught off guard when a local competitor emerges suddenly." (Company A.)

One interviewed company considered motivating their employees to gather information about competition, but it has never been implemented.

2.4 Domestic companies do not prepare their objectives ahead as opposed to international companies

As the companies need to determine criteria of performance, they also need to assess them regularly. We found out in this small sample of SMEs that Czech companies (not reporting to the foreign mother company) tend to use very simple metrics or indicators of performance. On the contrary, companies sending their results to the top management abroad use more sophisticated measurement system based on more KPIs.

Next, we saw that SMEs reporting to a mother company set their targets ahead of the fiscal year, whereas the rest aim to maintain or surpass their last year's performance and do not set fixed targets in advance. This fact emphasizes the conclusion that larger companies have a more sophisticated system which is used not only for assessment but for planning the objectives, too.

Conclusions

The goal of this study was to find out how Czech SMEs use performance measurement and reward systems and how these systems support market orientation of those companies. Our preliminary qualitative study suggests that SMEs tend to use "hard" indicators about company performance, whereas "soft" indicators are ignored. Also the reward system used by SMEs supports their short-term orientation. Moreover, this study suggests that Czech SMEs do not systematically monitor the activities of their competitors. We also found the differences in setting the objectives between Czech companies (without foreign mother company) and the international ones. All of these findings denote that the level of market orientation of Czech companies is far from optimal, and that the performance measurement and reward systems do not support market orientation.

These findings, if confirmed, could have serious managerial implications for SMEs. The short sighted hard-data driven performance and reward systems look relatively justifiable in the eyes of the SME owners, but they ignore the fact that such results are very likely the consequences of customers' decisions in the competitive market environment where long-term success requires more sophisticated tools. In some industries it could also support very aggressive marketing and sales behaviour, which could harm the company's reputation in the market. The failure to monitor competitors is a serious and in some cases also potentially fatal mistake. Companies, unless they have the monopoly, should fight for their customers and in order to fight successfully, they need to know their rivals. Even monopolistic companies could in long-term perspective suffer from the absence of any competitive benchmark. Not setting objectives well in advance could also have quite significant strategic consequences for the local SMEs. If there is no clear objective for the fiscal year, there is obviously no clear strategy how to achieve it, so the company is just drifting with little influence of its direction.

This study is based on qualitative data originated from in-depth interviews with CEOs and marketing managers. As such, it is not its goal to present statistically representative conclusions, but rather offer an insight into the current situation and individuate the heterogeneous problems. In this way, the findings should be validated by a subsequent quantitative research.

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