

The Model of Sustainable Performing of SMEs in Context of Company's Life Cycle

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ABSTRACT

The goal of the research is, studying the performance of SMEs and the factors affecting performance achieving, to propose performance measurement concept encouraging the sustainable development of SMEs and to suggest performance evaluation approach according to company's life cycle. The object of the study is SMEs from the sub-sector of manufacturing industry in Latvia. The authors create a model of sustainable performing of SMEs on the base of the results obtained from qualitative and quantitative research. External and internal business environment factors influencing effective performance of the enterprise and performance indicators that are to be supervised principally, according to the enterprise life cycle phases are included in the model. The developed model of SME sustainable performing has been tested in the sector of printing in manufacturing industry. Calculations and data processing were carried out using Microsoft Excel and EViews software.

Keywords: SME, sustainable performance, life cycle, model.

1. INTRODUCTION

An enterprise as a core of any economic system has a great impact on sustainable development of a state or region. Small and medium-sized enterprises (SMEs) are socially and economically important for their national economies, since they represent about 99 per cent of all active enterprises in the European Union. The importance of SMEs to the EU economy indicates a need to assess their performance in order to find appropriate performance measurement and management tools. These issues become very topical during the period of global economic recession.

The most popular form of business in Latvia is the limited liability company, which according to LURSOFT data, in the period from 1991 until 2010, accounts for approximately 60% of the total number of registered companies. Statistical data on the registration and liquidation of a specific form of commercial activity for the last 18 years reveal the issue of viability of the enterprises. For December 2009 25% of the enterprises registered in 2002 as limited liability companies did not survive 7 years. More than 70% of the companies registered earlier (in 1992 and 1993) were liquidated [10].

The problems within an enterprise arise from improper activities, incompetence or even negligence. Performance measurement system can significantly influence and support SMEs' organizational development. Effectiveness and efficiency shall be manifested in all business processes of an enterprise.

Previously conducted research works in the field of performance evaluation of SMEs have not solved all the arising problems due to the specific industry issues. Besides, several disputable questions exist, for instance, whether large companies' performance measurement models can be applied for the needs of small and medium-sized enterprises. It indicates

the necessity for continuation of studying the above-mentioned issues in order to find practical solutions.

2. DEVELOPING THE SYSTEM OF AN ENTERPRISE SUSTAINABLE DEVELOPMENT

Basing on various scholars' researches on issues of sustainable development [2, 3, 8, 11, 13, 17] the authors conclude, that the main point of a concept of «sustainable development» is - coordinated and systemic advancement of economic subject towards the aim takes place only when all three dimensions of sustainability: social, economic and ecologic - are incorporated simultaneously into subject's activities. In this respect the following factors of sustainable development, that are common to all enterprises, can be mentioned: 1) income, which is formed by consumers (clients) utilizing products and services, produced by the enterprise; 2) financial stability and positive dynamics of profitability; 3) competences and skills of the personnel; 4) inclusion of ecological issues in the enterprise's management process; 5) positive attitude of the society towards the performance of the enterprise.

The authors conclude that the sustainability of the enterprise depends on the management system of the enterprise, which provides effectiveness and efficiency of sub-systems, taking into consideration deviations from the state of equilibrium. It demands concretization of the possibilities of practical application of sustainable development concept in the enterprise, taking into consideration that all the processes supporting sustainability of the enterprise are mutually connected, interact, and functional process of each management level is being implemented through dimensions of sustainability. Thus, the quality of the enterprise management influences total result, taking into consideration innovative potential of the enterprise, which includes: management systems, finances, employees, technologies and production.

On his turn, a human being as a special element and factor of the enterprise system complicates functionality of the system with his social expressions, because only a human being can create an idea in this system and implement it. The authors conclude that viability of the enterprise in a long-term period depends on the innovative potential, which is based upon a creative approach that is being implemented by all the stakeholders of the enterprise – not only employees, but also shareholders and customers [9]. It is justified by the results of the implemented activities – discussions in the enterprises.

Important factors for the sustainability of the enterprise are being formed in the social environment. Social capital [7, 19, 21, 25, 26, 27] can be considered as one of the potentials of the enterprise development, which increases return from the use of other capitals. Therefore, to provide a possibility to acknowledge the linkage of the social capital with the enterprise performance in the context of sustainable development, management of social and customers' capital has become of vital importance. It influences productivity, competitiveness and sustainable development of the enterprise

(minimizes operative expenditures for obtaining information, accelerates circulation of information, lessens asymmetry of information and enhances development of new knowledge).

In order to improve efficiency of the system, which results from both enterprise's management and government efficiency, also small enterprises shall seriously turn to evaluation of its performance [4, 5, 15, 18, 22, 23]. Performance measures characterize the fulfillment of goals, but they can be used also as a strategic tool of the enterprise management.

Completing Stafford Beer's [6] idea about the significance of enterprise indicators in providing sustainability of the system, the authors consider that three levels of performance are being formed in the enterprise: *actual*, *target (planned)* and *standard*.

Actual performance of the enterprise is being formed in the current time as an actual return from the utilization of existing resources, taking into consideration existing restrictions. *Target (planned) performance* corresponds to the return that the enterprise plans to obtain from the utilizing of existing resources, taking into consideration existing restrictions. On its turn, *standard performance* of the enterprise is an eventual return that can be obtained by the enterprise if it develops existing resources, takes off the restrictions and uses the opportunities, which can be achieved taking into consideration influence of factors maintaining sustainable development of the enterprise. Potential performances of the enterprise include unused opportunities, which are the subject of possible development through using innovations and competent enterprise management.

The authors consider that it is possible to improve efficiency by utilizing the enterprise's performance measurement system, which includes dimensions of sustainable development in combination with the elements – processes supporting sustainable development of the enterprise: *production process, sales process, personnel management process, financial management process, accounting process*.

As a result of interaction between management levels and functional fields and taking into consideration management level, the following issues and characteristics incorporated in performance measures are being formed: 1) strategic level – strategic layout of production machines, choice of placement, development of new products, planning of labour force long-term development, providing profit, selection of accounting technical solutions; 2) administrative level – management of production flows and schedules, development of production price policy and sales promotion campaigns, providing wages, social benefits and acquisitions, analysis, budget planning, supervision of expenses and income, supervision of prime costs; 3) knowledge level – development and designing of new products, analysis of the market situation, research, identification of clients, forecasting employees development and careers, analysis of customers cash flow and survey of possibilities for decreasing risks, forming investment portfolios; elaboration of accounting methodology in the enterprise; 4) operational level – performance of production machines, load control, quality and material consumption analysis; resources and time invested in customers' service; personnel training and environment maintenance expenses, supervision of customers' cash flow and accounting operations.

The authors demonstrate their approach to enterprise performance measurement in the context of sustainable development, which is incorporated in the levels of enterprise management and functional areas, in a pyramid shape (Figure 1).

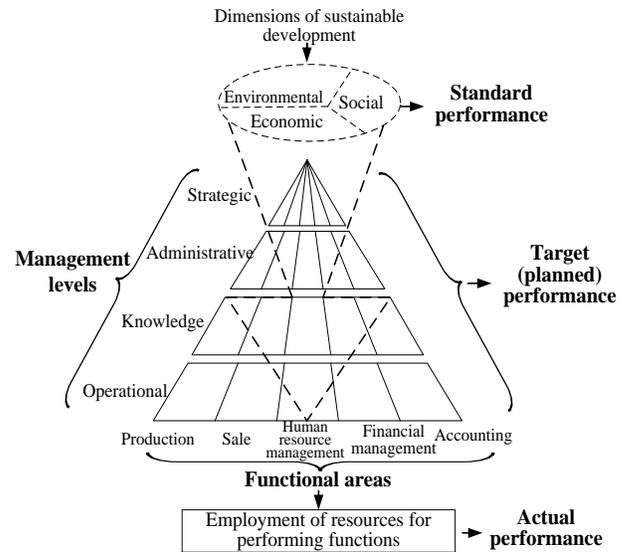


Figure 1 Application of an enterprise sustainable performance measurement system

During the period of its existence, the enterprise as a social-economic system passes through different functional stages, which in literature are defined as enterprise life cycle. Concept of the enterprise life cycle (ELC) [1, 8, 12, 14, 16, 20 24] was created within the enterprise management theory with an aim to explain changes in the enterprise in the context of time.

In literature there is no uniform division of ELC in stages, as well there is no uniform approach regarding number of stages and methodological grounds for defining the stages. A common feature of all the models of the ELC is that cyclic development of the enterprise can be foreseen, and the enterprise shall be able to function under the existing conditions with a future vision, where development possesses consequent and qualitative changes.

Therefore, enterprise management, which is oriented towards solving problems, which are characteristic to the particular stage (phase) of ELC, shall be considered as a condition enabling the enterprise to maintain sustainable performance.

3. EMPIRICAL RESEARCH

The authors carried out empirical research in 2010 with an aim to find out opinion of respondents (experts) about external and internal factors influencing the enterprise's performances, significance of performance measures in different stages of the ELC, and how the process of achieving goals is influenced by cooperation with business partners.

Survey questions were divided into 6 groups: the 1st group characterized critical influence of macroeconomic external environment and demand factors on the enterprise performance in different phases of ELC (questions 1–6); the 2nd group comprised questions about level of skills and abilities to be identified in the internal environment of the enterprise, which define forming of the enterprise offer and influence also performance (questions 7–21); questions of the 3rd group are about performance features, which are the basis for indicators describing performance (question 22–28); the 4th group represents questions connected with the social dimension of the

enterprise sustainable development, which is characterized by social relations between employees and customers and the influence of these relations on achieving goals of the enterprise and its performance (questions 29–50); questions of the 5th group are about acknowledging significance of various resources according to investment of these resources into the final product (questions 51–57); the 6th group contains questions, which are about identifying unfavorable factors that are being formed in both external and internal environment of the enterprise and on the level of social relations (questions 58–63).

Data obtained from the questionnaires were generalized, grouped and ranged by using *MS Excel PivotTable* tools. In order to obtain ordinal scale (rank) measurement, a bigger or smaller rank has been assigned to each factor on the ordinal scale. According to answers given by respondents, evaluation is made according to a 5-point system according to 5 criteria: *does not influence at all* – 1 point; *does not influence significantly* – 2 points; *partly does not influence* – 3 points; *influences* – 4 points, *influences a lot* – 5 points. The author accepts that separate phases of the cycle form the total life cycle of the enterprise, and obtained evaluations are gathered to assess influence of each element over the whole life cycle of the enterprise.

As in analysis process of separate factors, conditional evaluation, which is based on determining ranks, was used, for

defining interaction (linkage closeness) between separate factors and features, the authors carried out a correlation test. Coherence of rank features are defined using Spearman's (r_s) and Kendall's (r_k) rank correlations coefficients (using EViews 6.0 software). In order to obtain statistically valid determination of interaction between separate external environment factors and other manifestations influencing effectiveness of enterprise performance over different phases of ELC, the authors select those pairs of factors, which are characterized by Spearman rank correlation coefficient r_s at the n number of observations ($n=23$), with the degree of freedom $\nu = n-1$, if the following conditions is fulfilled: 1) coherence is statistically significant at the two-sided significance level with validity level ($\alpha = 0.05$), if $r_s \text{ computed} \geq r_s \text{ critical}$, where $r_s \text{ critical} = 0.428$; 2) coherence is statistically significant at the one-sided significance level with validity level i ($\alpha = 0.05$), if $r_s \text{ computed} \geq r_s \text{ critical}$, where $r_s \text{ critical} = 0.368$.

Results of the empiric study confirmed the results of the theoretic research results and the approach for assessing effectiveness of SME performance according the ELC phases. External and internal factors influencing performances of the enterprise and performance indicators to be supervised principally according to the phases of the ELC in correspondence with their significance were justified (see Table 1).

Table 1 Factors influencing the enterprise performance and performance indicators to be supervised principally corresponding to the phases of ELC according to their significance

ELC Growth phase	ELC Maturity phase	ELC Decline phase
<i>Factors of external environment influencing performances according to their significance:</i>		
<i>External macro-environment</i>		
Tax laws	Tax laws	Tax laws
<i>External micro- environment</i>		
Consumer purchasing power Qualified labour force Contacts with business partners in external environment Resource access	Consumer purchasing power Qualified labour force Obtaining new information Equal partners	Consumer purchasing power Qualified labour force Availability of external financial resources Relations with clients
<i>Factors of internal environment influencing performances according to their significance:</i>		
<i>Social</i>		
Quality level of clients' servicing Secure and stable relations with clients Intercommunication among employees	Quality level of clients' servicing Secure and stable relations with clients Intercommunication among employees	Secure and stable relations with clients
<i>Environmental</i>		
Ability to improve products	Ability to improve products Wide assortment of goods and services Ability to react to changes in market Ability to introduce innovations	Ability to improve products Wide assortment of goods and services Ability to react to changes in market Possibilities to improve manufacturing processes
<i>Goal achievement:</i> Value system of the enterprise, which is suitable for business partners; enterprise-wide uniform value system; mutual trust of employees		
<i>Performance features according to their significance</i>		
Rate of asset turnover Ability to provide revenues Cost structure	Rate of asset turnover Ability to achieve goal (productivity) Ability to provide revenues	Ability to achieve goal (profitability) Rate of asset turnover Cost structure
<i>Performance indicators to be supervised principally according to their significance</i>		
Liquidity Marginal revenues	Liquidity Productivity	Profitability Liquidity
Indicators of social and environmental factors according to the specifics of the sector		

Taking into consideration significance of the performance features in each phase of ELC, a totality of performance indicators that are to be supervised principally is being formed, as well as model of sustainable performing of SMEs, taking into consideration phases of the enterprise life cycle, was elaborated.

3. THE MODEL OF SMEs SUSTAINABLE PERFORMING

The model of SME sustainable performing comprises two stages: 1) Determining of phases of the enterprise life cycle and 2) Continuous improvement process, which is directed towards sustainable development.

To determine the phase of the enterprise life cycle identification parameters have to be applied. Basing on the theoretical study of ELC, the authors suggest using the following parameters for identifying the phases: 1) turnover dynamics, which is connected with forming of customers' basis as the source of enterprise revenues; 2) profit dynamics 3) balance of cash flow; and 4) level of processes' formalization (Table 2).

Table 2 Identification parameters in the context of enterprise life cycle

ELC Growth phase	ELC Maturity phase	ELC Decline phase
Sector growth rates (Ts) compared with the enterprise commercial turnover growth rate (Te)		
Te>Ts	Te ≈ Ts	Te<Ts
Dynamics of enterprise profit (Pe)		
Te>Pe	Pe>Te	Pe dynamics is negative
Balance of cash flow (CF) (operative - OCF, financial - FCF, investments - ICF)		
OCF+ FCF+ ICF-	OCF+ FCF- ICF-	OCF+/- FCF+/- ICF+/-
Level of formalization		
Low (till 20% of total processes)	High (40-80% of total processes)	Very high (above 80% of total processes)

The second phase of the model "Continuous improvement process" consists of four sub-phases: 1) the assessment of actual, standard and planned indicators which should be supervised principally, 2) determining the unused efficiency, 3) elaborating of action mechanism to improve enterprise unused efficiency and effectiveness and 4) correction of target values of performance measures.

4. TESTING OF THE MODEL ON AN ENTERPRISE OF PRINTING INDUSTRY

To test the model of the sustainable performing of SMEs the authors applied it in the medium-sized enterprise from the printing sector of the manufacturing industry.

In order to define enterprise compliance to a certain ELC phase, the authors took into consideration regularities of enterprise and sector development. For featuring dynamics of performances of the printing sector of manufacturing industry, the indicator of chain changes is being used. The authors consider that performance of the enterprises of printing sector can be characterized using data gathered by the Association of

Latvian Printing Companies (ALPC) about turnover dynamics of the members of the Association. In order to enable an enterprise to form the budget for the next periods, taking into consideration the tendencies of the sector, the ALPC forecasts for the near future (1 to 3 years) can be used. Forecasts are being obtained based upon the evaluation of the sector experts and taking into consideration processes and tendencies in the European and global printing production market. Using data of the particular printing enterprise, the authors determine the enterprise compliance to a certain phase of ELC according to the model of SMEs sustainable performing and identification parameters in the context of the enterprise life cycle (Table 2).

According to the carried out analysis the particular enterprise is in its decline phase and according to the performance features and measures (Table 1) of the decline phase of ELC actual level of the indicators to be supervised principally (profitability and liquidity) shall be determined, as well as social and environment influence indicators shall be determined according to the specifics of the printing sector.

In order to determine standard value of performance indicators to be supervised principally, it is necessary to use characteristics of the sector, which are connected to the turnover per employee or productivity.

To observe ecological indicators in the printing industry, the indicator of effective use of paper, which characterizes level of technology, was chosen.

In the group of social impact indicators, the authors choose dynamics of changes in number of sick-leave days, which according to employee's length of service and long-term sick-leave can be related to occupational sickness, as well as dynamics of expenditures allocated to compulsory health checks. As an important indicator, the authors mention expenditures allocated to improvement of professional skills of employees of the enterprise, per employee per year, because it indicates a possibility of enterprise sustainable development using innovations and knowledge as an element of support mechanism.

Basing on data provided by the ALPC and the printing enterprise, standard, target (planned) and actual performance measures of the enterprise according to the decline phase of ELC are summarized in the Table 3.

Table 3 Indicators for the printing enterprise in 2009

Name of the indicator	Value of indicator		
	Standard	Planned	Actual
Turnover, LVL	2 502 900	10% decrease of enterprise turnover in 2008 i.e. 1 100 000	838 928
Profitability, %	3.85	1.00	-0.29 (= 0)
Liquidity, coefficient	Sufficient liquidity =2.01	Sufficient liquidity =1.76	Actual liquidity = 1.41
Coefficient of effective use of paper	0.85	0.79	0.82
Expenditures to improvement of professional skills per employee, per year, LVL	Aspiration to max. rational possible level	25.00	12.89

Determining the unused efficiency is necessary to identify reserves that exist in the enterprise in the context of sustainable development. The relevant levels of the enterprise indicators to be supervised principally for 2009 are presented in Figure 2; 3 and 4.

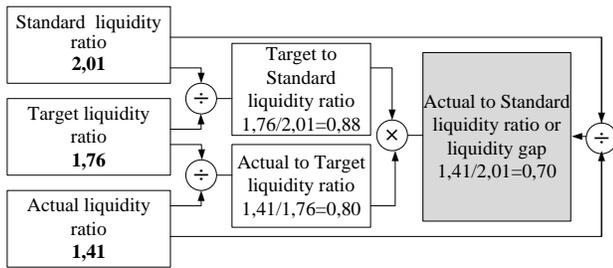


Figure 2 Assessment of the enterprise liquidity indicator

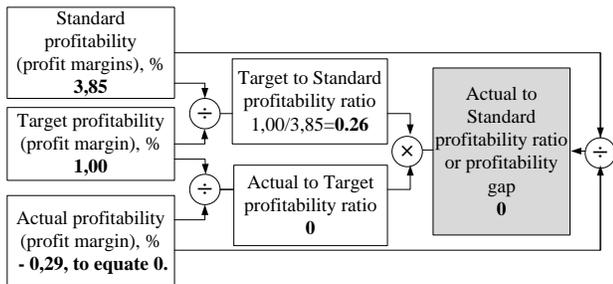


Figure 3 Assessment of the enterprise profitability indicator

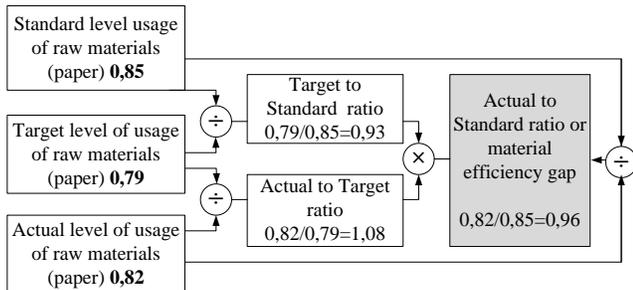


Figure 4 Assessment of the indicator of useful consumption of the paper by the enterprise

According to data presented in the Table 1, before the aging phase enterprise gets through the maturity phase with its characteristic features and indicators to be supervised principally – liquidity and productivity. Monitoring of these indicators, and especially that of productivity according to standard, planned and actual levels, helps the enterprise in maintaining effective management. The goal of the above mentioned might be prolonging maturity phase as much as possible in order to transfer into the new quality – in the growth phase again, and not to transfer to the decline phase. Problems of the decline phase, which occur in connection with low levels of profitability and liquidity, limit abilities of the enterprise to receive external financing support (bank credit, leasing) which is necessary in this phase to renew technologies and re-structure the enterprise. The author considers that enterprise position in the decline phase indicates the competence level of the enterprise management.

Activities to be implemented to improve enterprise unused efficiency and effectiveness, according to the author shall be connected with: 1) improvement of the value created by existing and new clients, and revealed by the commercial profitability; 2) improvements, connected with rising productivity, in use of labour force as the basic element of social capital; 3) optimization of cost structure with an aim to reach the lowest possible level of marginal revenues; 4) increasing efficiency of assets utilization. Commercial profitability of the enterprise may change if terms of enterprise income tax (tax rate; algorithm, which is used in tax calculations; cases when enterprise has obtained durable items – equipment and utilities) change. However, this indicator reflects how profit is being formed during manufacturing and sales of products and services. Knowledge and skills are of crucial importance in promoting innovations. Therefore, innovations, which currently cannot be envisaged without a social cooperation among enterprises and other market players, have to be considered as an element of the possible action mechanism, which provides an opportunity to improve the current level of effectiveness.

The printing enterprise in the decline phase can improve its performances by investments in innovations and technologies, taking into consideration that also the structure of production shall be changed. It can also be done by increasing customer equity, which is connected with revision of relations with existing clients and development according to the chosen strategy.

5. CONCLUSIONS

During developing the model of sustainable performing of small and medium enterprises in the context of ELC, the following conclusions have been made:

1. Ability of the enterprise to function in a coordinated and systemic manner, without losing capacity of performance in indefinite future, shall be connected with sustainable development, which incorporates all three dimensions: social, economic and ecologic. The basis for implementing sustainability is formed by the enterprise management systems, which provide functional efficiency and effectiveness of sub-systems, taking into consideration principles of sustainable performance.
2. Significant factors providing sustainability of the enterprise are formed in the social environment, because, in the context of an enterprise performance, management of knowledge, human and social capital is the «process of value creation», which shall be maintained taking into consideration the peculiarities of human resources management.
3. Development of the enterprise is cyclic. It is being created as a totality of stages, which forms uniform phases characterized by specific goals and tasks. Fulfillment of which fully drives the enterprise towards sustainable development.
4. An enterprise sustainable performance is connected with certain parameters, which change along the transfer from one stage of the life cycle to another. These parameters change, because goals, strategy, organizational structure, processes, technology and culture change. Thus the enterprise management, which is directed towards solution of the problems that are characteristic to the respective phase of the enterprise life cycle, is to be considered as a pre-condition enabling enterprise sustainable performance.

Several proposals how to increase efficiency and effectiveness of small and medium-sized enterprises were made:

1. In order to improve results achieved by small and medium-sized enterprises and maintain sustainable development, the authors recommend complementing indicators of the enterprise management system with economic, environment and social indicators, which correspond to the specifics of the sector of the particular enterprise. It shall be done to define standard and planned indicators in each dimension of sustainability.
2. Indicators, which are to be supervised principally and correspond to the phase of enterprise life cycle, shall be included in the competence of the enterprise financial and management accounting along with other indicators selected by the enterprise and characterizing enterprise performances. It shall be done to provide sustainable development and management decision-making in due time to reach this goal.
3. Taking into consideration phases of enterprise life cycle and applying the developed model of sustainable performing for small and medium-sized enterprises that can be used for performance control and management in the context of sustainable development, SMEs can improve their action mechanism according to the actual needs of the enterprise.

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