Measuring organizational performance in Indian MSMEs: A qualitative study

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Abstract

Micro, Small and Medium Enterprise (MSMEs) are key contributors to wealth creation and economic development of a country. Yet measuring their performance has been a challenge for researchers, data collectors and the policy makers. Non availability of structured historical data, virtual absence of regulatory filing, widespread under reporting of financial performance to avoid taxes and thick veil of secrecy on every bit of their information is a global phenomenon with MSME. Past research has experimented with various objective and subjective measures of organizational performance some of which were necessitated by non availability of accounting data. The present qualitative study, apart from putting MSME's contribution to the economic growth and corporate tax avoidance in perspective, deals with social and cultural mindset of small entrepreneurs in India. Multiple lines of enquiry like subjective indicators of performance measurement, non-intrusive techniques for on the spot assessment and cross verification with data available in the public domain were used to validate the findings. Study intends to meet the growing need for alternate tools and techniques to measure MSME performance. Further research in developing a comprehensive rubric of subjective measures for organizational performance is suggested.

Keywords: MSME, Organizational performance, Financial indicators, Non-financial parameters, Performance measurement.

Introduction

Performance Measurement is an exercise to establish the degree of success or failure of an enterprise. Kaplan & Norton, (1992) defined it as a set of indicators used to assess the degree to which organizational goals and objectives have been achieved. While entrepreneurs can measure performance of their enterprise with the help of data privy to them, the researchers are often deprived of such data due to various reasons forcing them to find creative and cumbersome solutions, developing complex rubrics and adopting multiple lines of enquiry to establish the organizational performance. Despite using extensive financial and non-financial indicators to assess an organization's performance, about 40% of variation in profit differential remains unexplained (McGahan and Porter, 1997) leading to the popularity of subjective measures. Our recent research project involved interviewing entrepreneurs in MSME sector to study time and effort devotion patterns of the entrepreneurs at certain time points and their corresponding organizational performance. The research couldn't progress unless the entrepreneurs in the selected cases were given a choice of not providing the financial data if they didn't wish to. They also wanted an assurance that the financial data, if disclosed, would not be published in the research findings or reports or any other publication. Facing similar situations, many researchers find crucial performance data either missing or misguiding or at the best insufficient. They are therefore on an endless mission to devise methods to pierce the opacity surrounding the organizational performance, particularly of MSMEs.

Literature Review

More than 3600 research articles were published on organizational performance during 1994 to 1996 (Neeley, 1999) making it one of the most studied topics in management. Organizational performance has two dimensions namely profitability and growth (Venkatraman and Ramanujam, 1987). Attributes like return on investment, gross margin percentage, earning per share etc. are used to measure the profitability while market size, sales, number of employees etc. are used to measure the growth of an organization. Researchers have used parameters like accounting data, financial market data, product variety, market size, research and development, team size, social impact, product quality, product rejection rate, employee retention, employee satisfaction and several other factors to measure an organization's performance (Richard et al. 2009). Subjective measures of organization performance have been used extensively in recent research with Rizov & Croucher (2009) using composite index of service quality, productivity level, product to market time, rate of innovation and profitability. Real et al. (2014) applied corporate success, group performance and employee satisfaction from Bontis et al. (2002)'s 10 item scale to find perceived business performance and argued that the scale was a reasonable substitute for objective measures. Faced with non-sharing of financial statements by private companies under study, Camps & Luna-Arocas (2012) used six item measure from Jashapara's (2003) scale to subjectively measure the organizational performance. Kunze et al (2013) relied upon senior manager's perception of company growth, employee retention and financial situations compared to their direct competitors. Significant correlation between subjective and objective measures of organizational performance was reported by Harris (2001), Coombs & Gilley (2005), Flanagan et al. (2005), Collins & Smith (2006) and Singh et al. (2016). Singh et al. (2016) while summarizing 207 measures of organizational performance used in 213 papers published during 2005-2007 in 5 management journals, also observed that the subjective measures were found to be valid and reliable

means to assess organizational performance. The studies listed by Singh et al. (2016) used subjective measures, objective measures or a mix of both.

Research Gap

Despite experimenting with various subjective measures, the current body of knowledge does not offer a comprehensive rubric to measure the organizational performance of small enterprises in absence of reliable and structured accounting data. The present study attempts to narrow this gap.

Research Objectives

MSMEs are crucial for wealth creation at the grass root level. Put together, they generate a significant percentage of a country's gross domestic product. Therefore any research on organizational performance would be incomplete if it excludes the important engines of economic growth namely the MSMEs. The objectives of present research are (a) to develop a set of easily accessible subjective indicators to assess the performance of MSMEs; (b) suggest additional lines of enquiry to validate the assessment of organizational performance; and (c) attempt to develop a framework of organizational performance rubric for MSMEs in absence of accounting data.

Research Methodology
Who are MSMEs?

Ministry of Micro, Small and Medium Enterprises, Government of India has prescribed following upper limit for investment in plant and machinery for manufacturing sector and investment in office equipment for service sector to be classified as micro, small or medium enterprise:

Table 3.1: Investment limits of MSMEs

Type of Enterprise	Maximum investment in plant and machinery (for manufacturing enterprise)	Maximum investment in equipment (for service enterprise)
Micro	Indian Rupees 2.5 million	Indian Rupees 1 million
Small	Indian Rupees 50 million	Indian Rupees 20 million
Medium	Indian Rupees 100 million	Indian Rupees 50 million

Source: Prepared by author basis data retrieved from https://msme.gov.in/know-about-msme on 12th October 2018

The Socio-economic Background of MSME

The term 'trade secret' has widest possible connotation for MSMEs in India. These entrepreneurs rarely talk about what they do, how they operate and the factors behind their growth. Not only outsiders like researchers, the competitors or the governments, even their close family members don't get insights of their revenues, profits, investments, markets, products, recipes, technology or taxes etc. (Makhija, 2019). India is a populous country where several enterprising individuals compete for limited resources and opportunities.

The country was ranked 77th (out of total 190) on ease of doing business and 137th on starting a business as per World Bank's 'Doing Business 2018' report. Struggling with not-so-business-friendly ecosystem and having invested years of hard work in their enterprise, the entrepreneurs become excessively protective about what they have achieved. In order to be successful, they not only need skills to launch, sustain and grow their enterprise, they also need skills to outsmart others to stay ahead in the race for economic survival and growth. Such an instinct drives them to build a protective wall of secrecy around their enterprise. They avoid participation in economic, demographic, academic or research studies and try their best to dodge even minimal regulatory filing system. They prefer not to disclose their identity or data and aggressively block all attempts to look at or photograph their premises, processes, people or papers.

Minimal Regulatory Filing

There are five key regulatory filing requirements relating to revenues or profits for MSMEs in India. These are:

(a) Filing a return of income under Income Tax Act, 1961 if the total income exceeds certain specified amount (the data needs to be audited by a qualified Chartered Accountant only when annual sales exceeds certain amount).

(b) Registration under Goods and Services Tax (GST) Act, 2017 if annual revenues exceed certain specified amount. Once registered, monthly or quarterly returns of purchases, sales and incomes are to be filed (the data need not be audited).

(c) Filing Annual Returns comprising of Balance Sheet and Profit and Loss Account, if registered under the Companies Act 2013 (registration under the Companies Act is not compulsory).

(d) Compulsory participation in the surveys carried out by National Sample Survey Organization (NSSO), Ministry of Statistics & Program Implementation (MOPSI) (the data is not verified and is collected on sectoral, regional or national level without traceability to any specific enterprise).

(e) Quarterly accounting data of sales, expenses and earnings to be filed by MSMEs listed with stock exchange.

A large number of MSMEs try to stay out of Income Tax and GST Act by splitting their operations in multiple firms. Minimal data available to Income Tax and GST authorities is not available in public domain. The returns filed under the Companies Act, 2013 are available for public inspection but the Profit and Loss Account giving insights into the revenues and profits is not open to public inspection except for large companies. As per report No. 582(73/2.34/2), NSS 73rd Round, July 2015–June 2016 by NSSO, MOPSI, India had 63.392 million unincorporated non-agricultural enterprises in June 2016 all of which except 4000 were MSMEs. As of 31st January 2019, a total of 281 MSMEs were listed on the exclusive stock listing and

trading platforms set up for MSMEs by Bombay Stock Exchange in 2012 *(Source: SME Statistics, retrieved from https://www.bsesme.com on 31ˢᵗ January 2019 at 13:13 hrs Indian Standard Time)*. A similar platform called NSE-Emerge launched by National Stock Exchange in 2012-13 had 186 listed MSMEs as on 6ᵗʰ February 2019 *(Source: NSE Emerge Quotes, retrieved from https://www.nseindia.com/emerge/live_market/dynaContent/ live_watch/sme_equities_stock_watch.htm on 6th February 2019 at 18:27 hrs Indian Standard Time)*. Thus barring 467 listed MSMEs, the researchers can never have access to accounting data of over 63 million MSMEs through a regulatory source.

Magnitude of Tax Avoidance

Almost all countries around the world expect their citizens to report financial transactions and earnings to the extent required for taxation and other legal purposes. However the fact remains that a varying proportion of the populations across the globe doesn't comply with these stipulations and non compliance is more prevalent in some countries than others. Many entrepreneurs resort to off balance sheet transactions in order to under report their earnings and thereby save on the taxes they pay to the exchequer. Tax evasion is a global phenomenon and India is no exception. According to OECD Economic Outlook 100 database, income tax payments constituted a little over 2% of India's GDP as against OECD average of over 9%.

Tax avoidance is more a norm than exception in India. The country lost USD 41.2 billion in corporate tax avoidance in 2013 which equalled 2.34% of country's GDP (Cobham & Petr, 2017). Effectively, it means that whatever income tax Indian citizens paid, an almost equal amount was lost due to tax avoidance.

Examining relationship between Happiness and Tax Morale, Lubian et al. (2011) concluded that people with higher tax morale are happier than others. India's 133ʳᵈ position out of 156 in the 'World Happiness Report, 2018 (Helliwell et al. 2018) is yet another indication of low tax compliance among its population. The above facts quantify the extent to which entrepreneurs do not disclose their sales, earnings and taxes and a substantial proportion of their enterprises are MSMEs who also escape regulatory income and tax filing system.

Why are MSMEs Important?

Despite such a high level of resistance to public scrutiny from MSMEs, any research on entrepreneurs or enterprises ignoring the MSME sector would be incomplete because of significant contribution it makes to the Gross Value Added and GDP of India. The MSMEs contributed 28.77% of India's GDP during 2015-16 *(Source: Government of India, Ministry of Micro, Small and Medium Enterprises, Annual Report 2017-18)*. Similarly, SMEs contribute 75% of European Union GDP and account for 70% of production worldwide (Bititci et al. 2012). Out of 63.392 million unincorporated non-agricultural Indian enterprises [Report No. 582(73/2.34/2), NSS 73ʳᵈ Round,

July 2015 – June 2016 of NSSO, MOSPI], 84.2% were Own Account Enterprises (OAEs) which were managed entirely by the individual entrepreneurs without hiring any employee on a regular basis. No research on entrepreneurs can ignore such a large proportion of the entrepreneurial community. The researcher therefore decided to study the MSME sector even though the exercise involved resistance by the entrepreneurs to give appointment, share data or permit disclosure of their identity.

Type of Research

Qualitative research is an approach to explore and understand the meaning individuals or groups assign to a social or human problem; it involves emerging questions and procedures; data collection is typically done in participant's settings and it renders complexity of a situation (Creswell, 2016). In absence of quantitative accounting data, the qualitative case study method was used to find how organizations performed on various subjective parameters and examine the findings in the context of circumstances existing at relevant time points. The organizational performance was assessed as part of a larger study to find time and effort devotion patterns of entrepreneurs at different time points. In-depth interviews were conducted to get perspective of organizational situation at the relevant time point, the activities they devoted their time and efforts on and how their organization fared on certain subjective parameters. Critics often claim that the findings of case studies can't be generalized (Yin, 2014). However, the case doesn't represent a population. The study of a case brings out a phenomenon that reflects the existing theory or contributes to reinforcement or building of a theory. Although the case study findings do not offer statistical generalization, they do offer analytical generalization (Yin, 2014).

Data Sources

Yin (2014) recommends multiple data sources to develop a converging line of enquiry in case studies. Four different data sources were used in the present study namely (1) subjective data provided by the respondents against structured questions during in-depth interviews to capture organizational performance on specific non-accounting parameters at different time points, (2) tour of the enterprise to get an idea of the size of factory or office, level of production activity, inventory levels, plant utilization, number of employees and overall business buzz in the enterprise, (3) scrutiny of the website of the enterprise and (4) Scrutiny of financial statements filed by the enterprise with Ministry of Corporate Affairs, if available.

Multiple cases make the study more robust and the evidence more compelling (Herriott and Firestone, 1983). Six cases were taken up for study out of which 3 entrepreneurs were known to be quite successful and 3 were known to be not so successful. Enterprises in manufacturing, trading or service sector demonstrate growth in different terms. Speaking in non-financial terms, the manufacturing enterprise may grow in terms of more

machines, latest technology or niche markets while trading enterprises grow in terms of broader markets, wide product range, number of outlets etc. Service enterprises grow in terms of complexity of services provided, specialities, team size, client reputation etc. In order to enhance the reliability of the findings, one each of 3 cases of successful entrepreneurs was taken from manufacturing, trading and services sector. Similarly, 3 cases of not so successful entrepreneurs included one each from manufacturing, trading and services sector. The cases are referred to in the study as C1, C2, ...C6 respectively.

Discussion

Alternate Measures of Organization Performance

In absence of accounting data in the research project, it was decided to consider performance parameters that entrepreneurs could comfortably share. The information was to come from the entrepreneurs during in-depth interviews. To deal with the possible recall bias in subjective measures caused by respondents inflating the performance while recalling the history, the researchers have to carefully clarify the question and restate the objectives of research (Singh et al., 2016). The respondents were reminded that the objective of the study was to understand their time and effort devotion patterns. This tactic helped get plain data of organizational performance without exciting the entrepreneurs or letting them get emotional about good or bad performance. To enhance the reliability of the measurement in the present research, it was decided (i) to obtain and use multiple indicators for subjective measurement; (ii) to examine the reasons for change in the parameters over time; (iii) examine data in the context of circumstances then existing instead of asking the entrepreneur whether the organization grew or not; and (iv) to take a comprehensive view of performance based on all factors. Subjective measures did not help calculate the precise rate of growth but helped categorize the organization as High Growth, Average Growth, Low Growth, Nil Growth or Negative Growth etc. Following performance indicators were used in the present research:

Number of Business Locations: Only growing enterprises expand in terms of additional place of business. The entrepreneurs generally won't invest in new location unless the existing one has been fully utilized or some potential opportunity is found in the new place. However, not starting an additional location does not necessarily mean that the organization didn't grow. Therefore this indicator should be used in conjunction with other indicators.

Ownership of the Business Premises: Because of limited resources, MSMEs tend to invest least in the office or factory space to begin with. Many start out of rented premises or from home or free space provided by friends or incubators. Decision to shift from such a premises to own premises indicates growth. At the same time, it is not necessary that growing enterprise must have own premises instead of a rented one. Therefore this indicator also has to be used in combination with other information.

Size of Office or Factory: Additional resources are required to expand the office or factory size. Such investments either come from past earnings or additional fund raising keeping the business potential in mind. Therefore such a decision indicates growth of enterprise. However, many enterprises grow in sales and profits despite continuing in the same premises for several years. Therefore a decision to continue in the same premises doesn't mean lack of growth of the enterprise.

Process Automation or Number of Key Machines: Decision to install more machines or automate an existing process is based on the logic of saving process cost, enhancing efficiency or growing output. Similar indicator can also be found in trading or service enterprise by looking at addition of facsimile machines, telephone lines, air conditions, water coolers, professional copying or imaging devices, tea or coffee dispensers, projectors and other apparatus.

Number of Products or Service Categories: New products or services generally fulfil the needs or desires of a customer; or help utilize existing infrastructure, facilities or skills; or acquire new markets or customers. Each of these situations indicates actual or potential growth.

Number of Price Points in Case of Few Products: Price points bring the flexibility of matching the product with customer needs. Introducing additional price points based on varied product or service features implies creation of additional capabilities or skills to offer the variety of features. Creating such capabilities is an indicator of growth.

Production Quantity: Higher production leads to more sales and margins. This is a safe indicator of growth except when additional production has led to accumulated inventory. Additional enquiries should bring out such a phenomenon, if any.

Market Size: More products, services and capabilities are required to capture bigger and wider markets. The enterprise with expanding geographical presence can therefore be assumed to be a growing organization in absence of contrary indicators like declining sales or profitability. The researcher has to examine if the growth in the market is in sync with enhanced production or dispatches.

Sales Team or Channels: Sales teams and channel partners help grow sales. However, there is an initial cost for each new recruit or new channel partner unless they bring in sufficient sales. Sometimes new sales team or channel partners cannibalize the existing sales. If these side effects are taken care off then growth in sales team or appointment of additional channel partners is a good measure of measuring the growth.

Number of Employees: Most entrepreneurs in MSME sector work by themselves. They are highly cost conscious and don't hire anyone unless they are confident of achieving a measurable benefit. A growing team size is therefore a safe indicator of enterprise growth.

Number of Computers: Computers help improve efficiency and work quality. Decision to buy additional computers is always driven by desire to do better. Small

entrepreneurs won't buy an additional computer if the existing one is not fully utilized. Therefore continued investment in computers is an indication of growing organization.

Customer Portfolio: Careful study of changing customer portfolio would bring out the reasons driving such changes. Growing number of customers or switch to bigger or profitable customers etc. are the indicators of growth.

Average Value per Sale Transaction: Customers place bigger orders once they are satisfied and confident. Once the enterprise crosses stability or break even stage, the entrepreneurs tend to select high value or bulk orders to enhance return on their efforts. Therefore gradually increasing average value per sale transaction is an indicator of product or service acceptability and corresponding growth.

Cases Studied

Case 1: Manufacturing, high growth (C1)

The enterprise was set up in 1975, took 7 years to stabilize and another 3 years to reach growth stage. It manufactured Filter Press for use in various process industries. Data obtained during in-depth interview after second level categorization showed that the enterprise achieved high growth.

Case 2: Trading, high growth (C2)

The enterprise is a retail showroom of plywood, laminates, hardware and fittings. Set up in 2009 by an experienced entrepreneur, it stabilized in one year and grew aggressively in the next year. Subjective data obtained from the entrepreneur, when converted to second level categories showed very high growth of the enterprise.
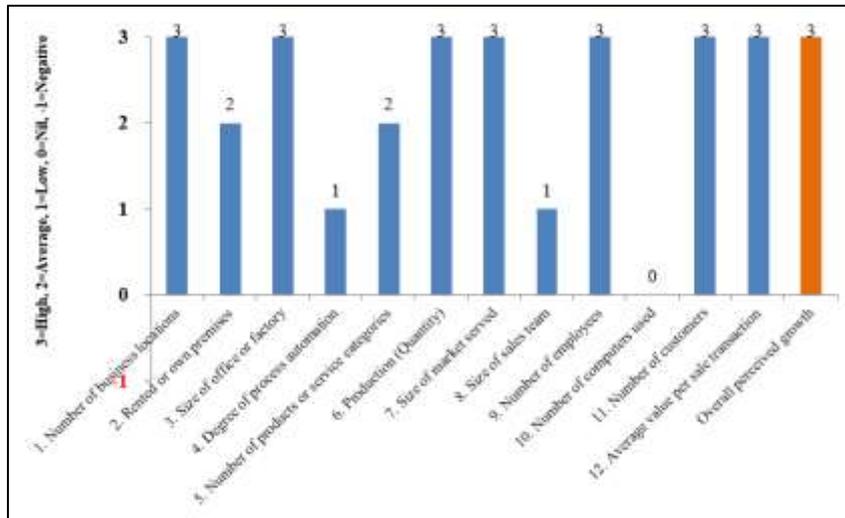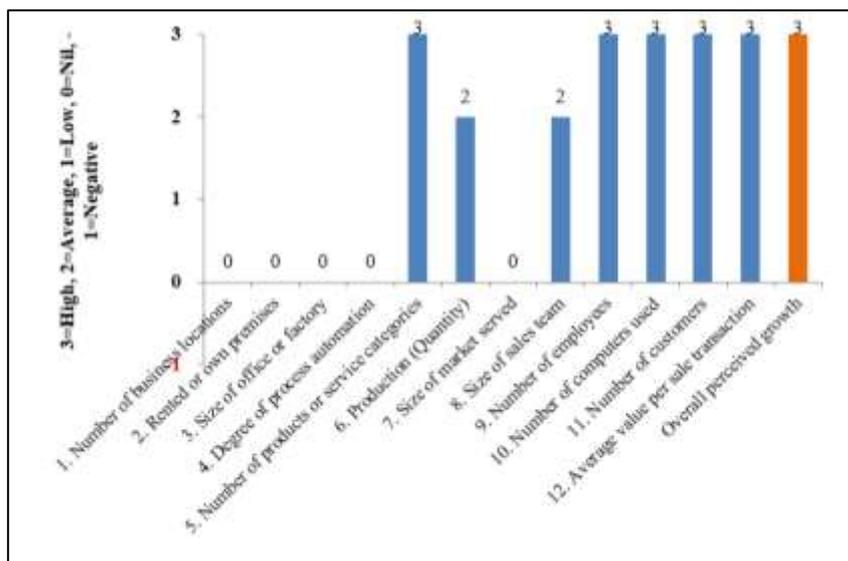

Fig. 1: Performance of C1

Fig. 2: Performance of C2

Case 3: Services, high growth (C3)

The enterprise was set up in 2007 to impart art and craft training to school going children. The business stabilized in two years and witnessed continuous growth over next two years, expanding the branch network and introducing new business verticals. Data shows high growth of the enterprise on several parameters and overall basis.

Case 4: Manufacturing, average growth (C4)

The enterprise manufactures women's traditional dresses and was set up in 2005. It reached break-even point within a year but took another 5 years to achieve high production and sales. Apart from production quantity, data obtained on several other parameters showed average organizational performance.

Case 5: Trading, low growth (C5)

This convenience store was set up in 1985 in a sparsely populated locality. It took two years to stabilize. While growing population helped in growing sales, aggressive competition from newly set up stores in the vicinity snatched its customers away. In absence of any clear marketing strategy, the enterprise continued to survive without much growth in subsequent years. Data provided during in-depth interview shows low growth it achieved during 5 year period under study.
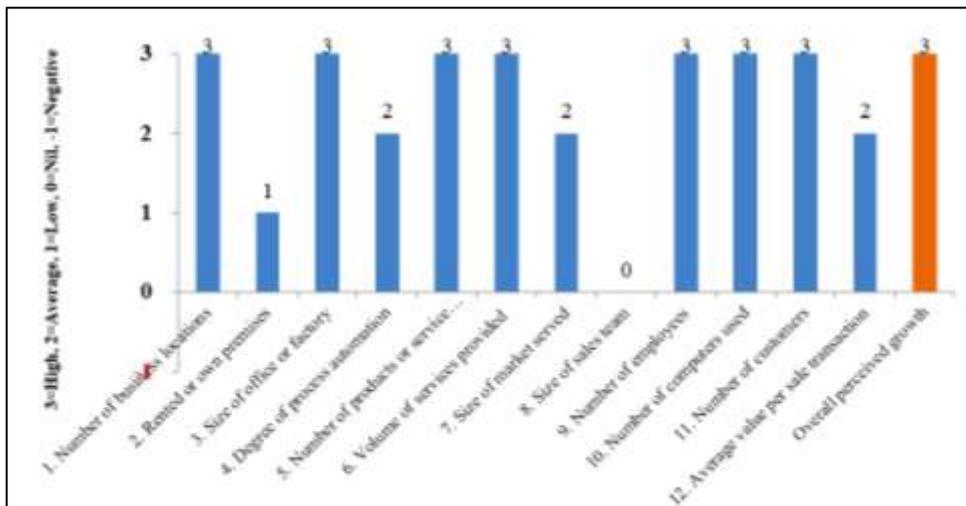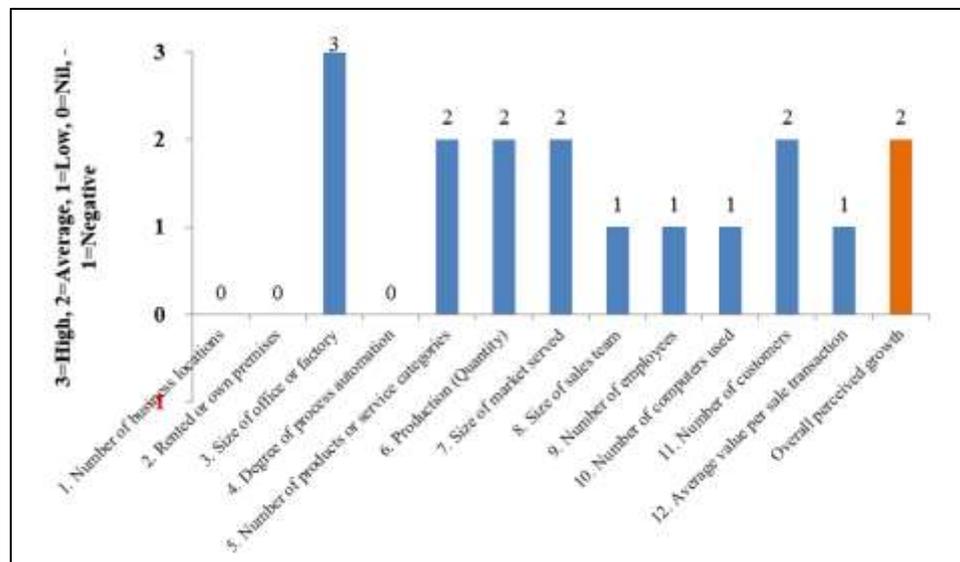

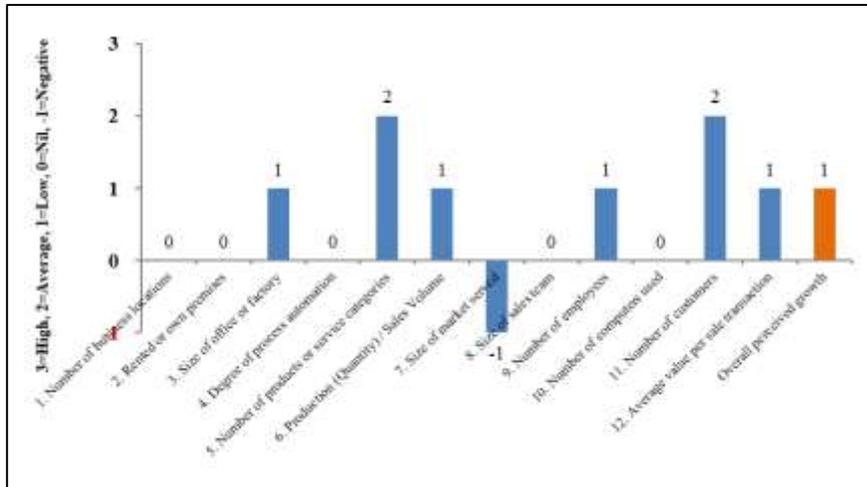**Fig. 3: Performance of C3**

Fig. 4: Performance of C4

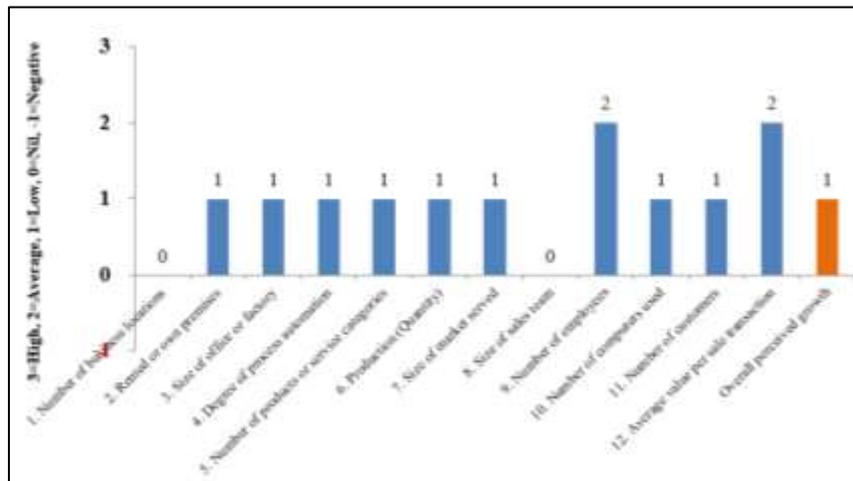**Fig. 5: Performance of C5**

Fig. 6: Performance of C6

Case 6: Services, low growth (C6)

The entrepreneur is a marketing consultant and undertakes field research projects. Having set up his enterprise in 1995, it took him only a year to stabilize because of past job experience and good network. However, next 11 years did not bring much growth in his organization as is seen from data. The overall growth of the organization appears to be low.

On the Spot Data Validation

In-depth interviews were followed up by instant tour of the enterprise where the researcher minutely observed the level of manufacturing or other activity, the level of inventory in the store, the shop floor and warehouse, number of employees working in the premises, level of paper work and communication among the employees, type and number of visitors and vehicles etc. The observations were converted to written notes by end of the day to avoid chances of forgetting any trivial yet important point. These observations helped reinforce the assessment of organizational performance.

Retrieving Data from Additional Sources

Most organization had their website. About one hour was devoted to study each website to see if there were contradictions in the organizational performance emerging from the data obtained during in-depth interview and what appeared on the website. Attention was paid to the product portfolio, markets, team details and technical details of the product range. Discussions with entrepreneur in case C1 gave an impression of a growing enterprise. However, the level of production activity, number of employees, movement of material and vehicles, trophies and awards received in various trade shows etc. as observed by the researcher was far higher than the idea emerging from the interview data. Website of the enterprise also gave much better and stronger picture than reported by the entrepreneur. The enterprise was a limited company and was obliged to file its financial statements with Registrar of Companies. Examination of its financial records on the website of Ministry of Corporate Affairs surprisingly showed modest sales and profits. Putting all data sources in perspective, it appeared that while the performance was being under-reported in regulatory filing, the answers

coming from entrepreneur during in-depth interview gave a fair indication of growing enterprise. Tour of the enterprise, display of awards and trophies and scrutiny of company's website showed that it was very high growth enterprise.

Conclusion

MSMEs avoid disclosing their revenues, profits and tax liabilities. Questions related to accounting data are perceived by them to be invasion of financial privacy. However, non-availability of data should not discourage researchers from adopting alternate channels of enquiry as leaving research of MSME sector altogether would deprive the policy makers and entrepreneur community from the benefits research would bring in shaping their future.

Limitations

The study has following limitations:

(a) One may be tempted to calculate percentage growth on few of these indicators like quantity of production, number of customers, average value per sale transaction, number of employees etc since these data points are numerical. Such an approach may be erroneous as each of these indicators would have a varying degree of impact on the financial performance of an organization. Again, the impact of the same indicator on the organizational performance may vary from enterprise to enterprise. A safe and reliable approach for the research would be to categorize the growth of an organization on each of these indicators as high, average, low, nil or negative and then categorize the organization as whole to be high growth, average growth, low growth, no growth or negative growth organization.

(b) Care should be taken while using the above indicators since the growth in these indicators over a period of time is 'generally' an indicator of organizational growth unless proved otherwise. Conversely, lack of growth in these indicators over a period of time is 'generally' an indicator of lack of organizational growth unless proved otherwise. Therefore, any one or even a few of these indicators would be insufficient to establish the growth or otherwise of an organization. Relying on too few of the above indicators may lead to misguiding conclusions since a genuinely growing organization might not have grown on all of these indicators or growth in some of these indicators might not have led to actual growth in an enterprise. Using all of the above indicators together provides a sound basis of categorizing the organizational performance since it is highly unlikely that the organization shows growth on all of these indicators and yet did not achieve any financial growth. On the other hand it is highly unlikely for an organization to achieve financial growth without growing on any of these indicators.

(c) If an investigator gets an opportunity of touring the organization, observing the manufacturing or other facilities, meeting some operational employees apart from the entrepreneur himself etc. then the observations, discussions and cross verification of information would further help him validate the categorization of overall organization performance based on the above indicators.

Way Forward

The relevance and impact each of the parameters studied in the present research on the organizational performance varied from case to case. More research is needed to establish the impact of each of these alternate measures on the organizational performance and the degree to which each of these is relevant in a given case. Further research is suggested to develop a rubric comprising of multiple measures with flexibility of varying their individual significance in the given case.

Note: A portion of this study was presented at Thirteenth Biennial Conference on Entrepreneurship held at EDII, Ahmedabad during 20-22 February 2019.

Conflict of Interest: None.

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