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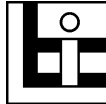
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Value Based Management in Small and Medium Enterprises

Analysis of internal and external impulses and possibilities of
implementation

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Arbeitspapier Nr. 9-1

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1 Abstract

Since the beginning of the 1990s the shareholder value concept is discussed intensively as being a management concept especially for listed enterprises. In contrast to the immense relevance of small and medium enterprises (SME) for the German economy, value orientation of the management of SMEs is hardly discussed in the literature. In our paper we analyse whether value based management (VBM) and value based management accounting is of importance for SMEs which typically do not have access to the capital market. Based on a detailed literature analysis in a first step we examine internal (such as personal liability of the entrepreneur and the successor problem) and external impulses (e.g. Rating and Basel II) for the implementation of VBM in SMEs. In a second step we analyse the possibilities of implementing VBM in small and medium enterprises. By identifying important value and risk drivers, we show that the specifics of SMEs necessitate a stakeholder value orientation more than a sole shareholder value orientation. This is due to the high interaction of SMEs with their environment. In addition to the capital orientation, social aspects have to be considered in a value based management of SMEs as well. Based on our findings we derive criteria to evaluate the adequacy of management accounting instruments to pursue value orientation in SMEs.

2 Introduction

Value Based Management (VBM) has been widely discussed in the economic literature. Although Small and Medium-Sized Enterprises (SMEs) are a crucial part of the German economy, there are only few works on the reasonability and applicability of VBM as a management concept for such companies. By contrast, environmental changes such as new regulations for granting credits (Basel II), The Corporate Sector Supervision and Transparency Act (KonTraG), and efforts to implement IFRS for SMEs are fostering the usefulness of the basic principles of VBM as a management concept for SMEs. Besides these external impulses internal stimuli like successor problems and often-times unstructured and intuitive decision making additionally enhance this usefulness and necessity. Because of the discrepancy between the lack of studies on VBM in SMEs and the rising reasonability and necessity, our aim is to explicate the drivers of VBM for SMEs, to consider the specifics of SMEs when implementing basic principles of VBM, and to derive criteria to evaluate management accounting instruments if they are suitable to support a VBM and meet the specific requirements of SMEs.

The remainder of the paper is structured as follows. First, we take a closer look at the basics of VBM and identify its basic principles. Second, we define small and medium enterprises and identify some of their typical specifics. In the next section we discuss external as well as internal impulses that foster the need and reasonability of VBM in SMEs. Subsequently we consider implementation barriers and discuss the special role of other stakeholders in the context of SMEs. Finally, we derive criteria to evaluate the usability of value based accounting instruments in SMEs and end the paper with a conclusion.

3 Basic principles of Value Based Management

Starting in the late 1980s and early 1990s the discussion about the shareholder value as a corporate goal led to the evolution of value based management (VBM) concepts (for shareholder value and value based management see for example Rappaport 1986, Stewart 1990 and Copeland et al. 1990). The concept of VBM has been widely discussed since then and found a large acceptance and adoption among large and listed companies. Although different value based management concepts have emerged over time, there are some basic principles of value based management inherent in all of those concepts. Although value based management was originally designed for and is primarily used by (large) public companies the reduction of VBM-concepts to these basic principles reveals that the original intention of shareholder value and thus VBM is applicable to SMEs as well.

The main intention of VBM is to increase shareholder value, i.e. the value of the company. In order to increase a companies' value investments have to yield higher returns than the costs of capital. As the costs of capital include the costs for equity, the risk of an investment has to be considered to adequately include the risks borne by the investors, i.e. the shareholders (the most common concept to consider the costs for equity is the Capital Asset Pricing Model (CAPM). For the CAPM see Sharpe 1964 and Lintner 1965). Thus, an integrated risk-return-perspective is the most crucial aspect of the VBM. This leads to an optimization or at least an improvement of resource allocation compared to an isolated return perspective.

The second basic principle of VBM results from the investment perspective of the concept. All decisions have to lead to higher returns than the costs of capital considering the life cycle of the investment. In sum, it is essential that all decisions are viewed from a multi-period perspective. Thus, VBM automatically implies a long-term and future orientated approach. This results in a high importance of the strategic and long-term orientation of the management's decision making process and in long-term chance-risk considerations. To make the goal of increasing the companies' value manageable, value drivers have to be identified which have a substantial influence on the companies' value. These value drivers have to be considered in management decisions to operationalize the overall goal of increasing the companies' value.

Although all concepts intend to measure the companies' value and its change over time to control the effects of the decisions taken, the pure knowledge about the value drivers and the two basic principles should enable any company to increase the companies' value even if it cannot be measured by market capitalization or is not calculated frequently. Following the two basic principles should lead to an enhancement of capital allocation, a long-term and more strategic focussed management and decision making process. Additionally, considering the value drivers should lead to a management consistent with the companies' economic goals. Thus, the principles of VBM-concepts are generally suitable for every company without regarding its size and use of capital markets.

4 Definition and relevant specifics of Small and Medium-Sized Enterprises

In this section we define various variables used to describe the heterogeneous group of small and medium-size enterprises. The term SME covers a wide range of definitions and measures, varying between different countries and sources of reporting SME statistics (Ayyagari et al. 2007; Abouzeedan and Busler 2004, pp. 156). It can be distinguished between quantitative and qualitative criteria used for the definition of SMEs. Commonly used quantitative criteria in Germany are the

number of employees and the turnover of a company. We therefore follow the definition of the Institute for SME-Research Bonn, Germany (IfM Bonn) which defines SMEs to have a maximum of 499 employees and a cut-off of €50 Mio. turnover per annum (IfM Bonn 2004, pp. 3).

A definition of SMEs only in terms of quantitative aspects seems to be problematic, as these criteria will change over time and also industry specific differences have to be taken into account (Legenhäuser, 1998, pp. 20). Quantitative criteria can primarily be seen as means to secure the statistical ascertainability of SMEs (Wolter and Hauser 2001, pp. 30) and have to be complemented by further qualitative factors to understand the relevant aspects of corporate management in SMEs. Besides the legal and economical independence of SMEs, it can be stated as a second aspect, that in the field of business management the proprietor, the manager, and the entrepreneur are all the same person. Ownership, management, success and liability are combined in the person of the owner-manager. SMEs often manage their company on the basis of experience and intuition as the owner-manager is mainly trained in professional and technical skills rather than having a university degree in business management (de Preux et al. 2003, pp. 118-121; Pfohl 1990, pp. 18). The role of the owner-manager is of great importance because he usually is the lone decision maker. Patriarchal leadership and unsystematic planning are typical for SMEs. Because of the close relationship between the owner-manager and his company the corporate objectives are deeply influenced by personal aims of the entrepreneur. Therefore the objectives are multidimensional and besides economic targets (e.g. profit-maximisation) also meta-economic objectives, such as self-actualisation, long-term maintenance of independence, striving for power but also social aspects are incorporated (Behringer 2004, pp. 123-129; Pruzan 1998). In contrast to larger companies SMEs are often integrated in a large network of relationships. Next to personal relationships to the employees, long-term connections to customers, suppliers, and bank loan officers of the housebank exist, which are critical for the corporate success (Schmalenbach-Gesellschaft 2004, pp. 107). Moreover, the owner-manager is deeply involved in short-term, operative activities and his work suffers from cash flow related constraints, which often leads to a lack of strategic orientation of the business management (Spence and Rutherford 2002, pp. 18). Constrictions due to the poor endowment of critical resources are also typical for SMEs.¹ As SMEs usually do not have access to the organized capital markets, they are financially highly dependent on sufficient funding through the housebank, which can be seen as an important stakeholder of the firm. Besides these financial dependencies individual-related and customer-related dependencies are observable among SMEs as well. Many SMEs tend to produce only one or two standard products for a narrow range of customers. They then are critically dependent

¹ In her paper RANGONE identifies the following critical resources of SMEs: financial, human and organisational resources as well as know-how and (managerial) competencies, see Rangone 1999, pp. 235-236.

upon these customers for their existence and have relatively little power to raise prices (Levy and Powell 1998, pp. 183). In addition, there are often only one or two important know-how bearers in the company and this causes further dependencies on these employees and often makes short-term adjustments of personnel capacity difficult. The above listed specifics of SMEs are typical but of course will not all be found in every small or medium-sized business as the group of SMEs is very heterogeneous.

5 Internal and external impulses for the implementation of value based management in small and medium enterprises

Even though German small and medium-sized enterprises are usually privately owned (in terms of being non-listed companies),² there are several aspects that support the implementation of a value based management concept also in these companies. First of all, basic factors of a VBM concept can be identified, that are generally applicable and will promote the efficiency of any company regardless of its size or legal form (de Preux et al. 2003, pp. 120-121). That is for example that implementing a VBM-strategy requires a deep evaluation of the existing strategy before it can be adjusted to value orientated principles. The whole strategic planning process of a company is herewith verified and therefore benefits from implementing VBM. Another general benefit of VBM is that the specific value and risk drivers, that are crucial for a companies' economic success, have to be identified and managed in a VBM framework. Further possible benefits are efficient resource allocation, directing the organisation to value acquirement, creating a basis for the performance measurement and incentive system, determining the responsibilities within the organisational structure, and defining the reporting structure (de Preux et al. 2003, pp. 120-121).

Besides these general benefits of implementing a VBM concept there are several SME-specific impulses, which determine the need of VBM especially in SMEs. These impulses can be systemized by their causation in external and internal factors and will be discussed in the following.

5.1 External impulses

As a general starting point it can be stated that regardless of their size all enterprises compete for the scarce resource of capital. To be successful on various product- and service-markets it is essential for all companies to be competitive in the provision of financial resources (Gleißner and Füsler 2003, pp. 313). In this context the comparatively low equity ratios, which can be observed in a mul-

² In 2002 69,9% of all German SMEs were led as sole proprietorships, 15,4% were led as limited liability companies and 12,6% were led as partnerships, see IFM Bonn 2004, pp. 12.

titude of German SMEs, are particularly concerning.³ In 2003 the proportion of German SMEs which showed an equity ratio of less than 10% and which therefore could be identified as undercapitalized was 35,7% (Creditreform 2003, pp. 13). Only 18,3% of the SMEs disclosed an equity ratio of more than 30%. The reasons for this low extend of equity in German SMEs are manifold. First, most SMEs do not have access to organized capital markets as they do not fulfil the requirements of modern capital market instruments concerning profitability, size and transparency (Brezski et al. 2004). The ability to raise external equity usually depends on the expected value gain of the external investors. As we already pointed out, the owner-managers of SMEs also have other objectives besides economic growth and profitability (such as self-actualisation or social commitment), which often discourages external investors. Second, SMEs often exemplify an extreme degree of control aversion, which is defined by CRESSY AND OLOFSSON as an aversion to the sale of equity to outsiders (Cressy and Olofsson 1997). In their survey they found that almost half of their sample (285 companies) displayed a willingness to sell the whole firm rather than to take on new owners. Modern types of equity finance such as private equity would lead to a destruction of the traditionally grown corporate structures and would implicate a constriction of the autonomy of decision making of the owner-manager and are therefore usually rejected (Paffenholz 2002). Third, the German taxation laws may originate low equity ratios. For most SMEs retained earnings are the main source for new equity (Rehm 2003, pp. 33-34; Hughes 1997, pp. 157). But the German taxation laws provide incentives to diminish the profits shown in the balance sheets by making use of fiscal revaluation options to minimize their tax burden.

The equity-deficit of many SMEs results in an increased demand for debt. Although one can observe a growing acceptance of substitutes to the traditional bank loan such as leasing or factoring,⁴ capital procurement among SMEs will stay highly dependent on bank loans. Within debt financing 60 % of all German SMEs regard credits granted by their so called "housebank" as the most important source of capital. (Rehm 2003, pp. 34). SME financing thereby is substantially affected by the relationship banking, which is primarily based on a traditionally grown long-term relationship with the respective housebank. In his survey, LEIDIG found out that 47% of the interviewed companies had business connections to their housebank for more than 25 years (Leidig 2004). All in all one can conclude that fund raising of German SMEs strongly depends on bank loans granted by their housebanks.

³ The average equity ratio of German companies decreased from 30% in 1967 to 18% in 2003, see Winkeljohann and Diekel 2004, pp. 82.

⁴ The number of SMEs, which used leasing as a finance instrument increased by more than 70% between 1999 and 2002, see Achleitner and Fingerle 2004, pp. 23.

Especially the regulatory changes caused by the implementation of the New Basel Capital Accord (Basel II) at the beginning of 2007 and the herewith associated interconnection of the credit accommodation with a bank-internal rating provide an inducement for SMEs to implement value based principles in their corporate management. Basel II causes a more risk-adjusted credit-pricing and results in a spreading of the interest rates of the granted credits in the way that those SMEs with a good creditworthiness (determined by bank internal-ratings) will have to pay less for a credit, and firms with a higher credit risk will have to pay higher interest rates. For this reason, SMEs gain more influence on their individual credit costs and will try to take measures to optimize their rating. By looking at the rating criteria and the typical elements and objectives of VBM a huge intersection can be observed.⁵ This finding is supported by the fact that a good portion of rating-related literature consistently reverts to sections of the VBM-related literature (Koch 2003, pp. 268). In the following, we discuss some important interconnections between VBM and rating and exemplarily show measures to improve the rating which thus has a positive effect on the companies' value.

One example for this interconnection is that one of the main objectives of VBM is creating (shareholder) value, and that is to say strengthening the equity basis. This leads to an increase in the equity ratio and thus to an improvement of the final rating grade.⁶ The importance of the equity ratio as an indicator for the security of a credit is easily comprehensible by keeping in mind the fact, that many SMEs are short of assets, which can be used as collateral (Lin and Sun 2006).⁷ Therefore, it seems to be more than plausible that SMEs should focus their corporate management on strengthening the long-term equity base and thus should implement value based instruments. Another important criterion for bank-internal rating systems as well as for the calculation of the shareholder value is the annual cash flow. This ratio is one of the central determinants of the shareholder value, which is traditionally calculated as the sum of the discounted free cash flows and determines the amount which could be distributed to the shareholders (de Preux et al. 2003, pp. 110). The cash flow also shows a companies ability to meet its payment obligations (and thus its credit obligations) in future. For this reason an increasing cash flow c.p. leads to a better rating grade and thus has a direct and an indirect effect on the shareholder value calculated by the Capital value method. The shareholder value is on the one hand directly influenced by the ascended cash flow, which is the denominator of the calculation formula of the shareholder value. It is on the other hand indirectly influenced by the shrinking discount rate caused by the reduced costs of capital as a result of the improved rating grade.

⁵ For more information about structure and criteria of Basel II-conform rating systems of German banks see Flacke and Krol 2005, pp. 146-148.

⁶ The equity ratio is the most important figure to assess a company's financial situation, see Füsler and Heidusch 2002, pp. 111.

⁷ One of the main reasons for refused bank loans are too low equity ratios, see Leidig 2004, pp. 227.

Besides these quantitative rating criteria we also assume a positive effect on a firms' value by meeting the qualitative rating requirements. Pertaining to the qualitative rating criteria the quality of the management and the support of the decision making process by using (value based) accounting instruments is gaining in importance. In this context, a consequent future-oriented management accounting and risk management will lead to a better rating grade. SMEs should perceive the actual external pressure caused by the changes in the credit policy of their lenders⁸ as a chance to eliminate the so far existing weaknesses concerning the insufficient planning and strategic orientation of SMEs.⁹ Several authors find empirical evidence that there is a positive correlation between planning activities and profitability of SMEs (O'Regan and Ghobadian (2004); Schwenk and Shrader (1993); Bracker et al. (1988)). O'REGAN AND GHOBADIAN even found out, that not necessarily the type of the pursued strategy is important, but the explicit formulation of a strategic plan and the consequent implementation of this strategy (regardless of the actual strategic focus) already is an important factor of success in SMEs.

All in all it can be stated that VBM is demanded by credit granting banks and will be rewarded in form of lower credit costs (Gleißner and Füsler 2003, pp. 233-236; Pape 2004, pp. 39). The increased cash flow and the decreased cost of debt will c.p. result in an increasing shareholder value, inter alia because of the reduced capital cost rates used in profit concepts (e.g. EVA) or in the capital value-method (Behringer 2004, pp. 156; de Preux et al. 2003, pp. 110-111). The following figure exemplarily illustrates possible interactions between VBM and rating requirements concerning Basel II.

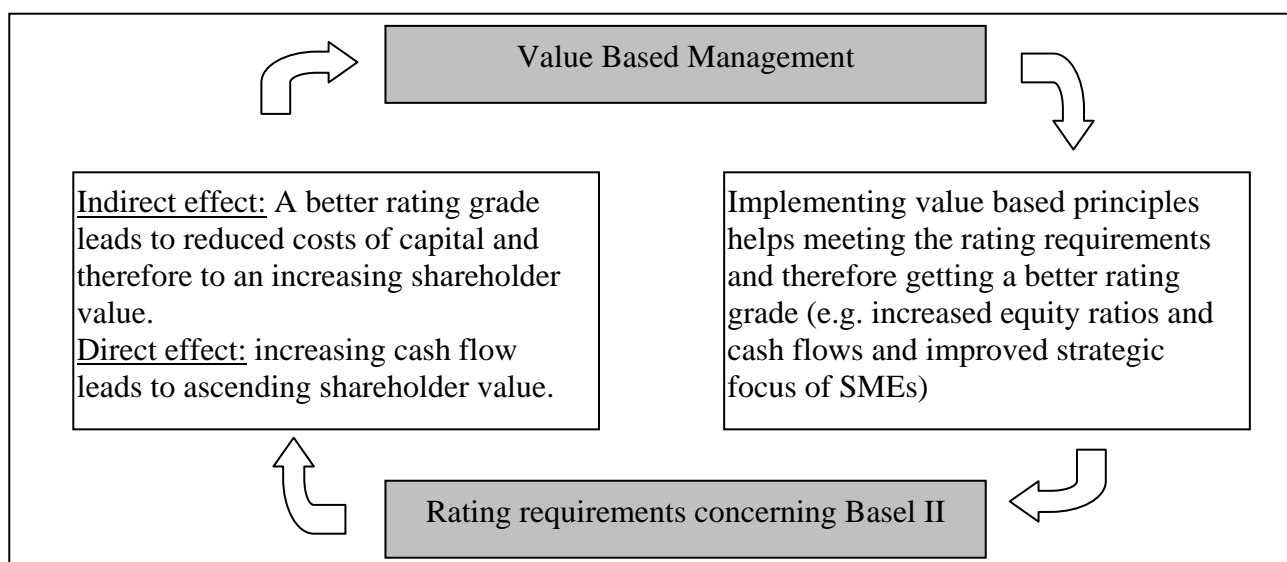


Figure 1: Interaction between VBM and rating requirements concerning Basel II

⁸ LEIDIG identified changes in the credit policy of banks as the second important reason for refused bank loans, see Leidig 2004, pp. 227.

⁹ For empirical evidence of the deficits in formal planning among German SMEs see Flacke and Krol 2005, pp. 156-157 and for deficits in planning among U.S.-SMEs see Perry 2001, pp. 201.

Many authors argue that the constantly growing influence of (institutional) investors is the main reason for the increasing necessity of a value based corporate management of (listed) enterprises (Palli 2004, pp. 49-50; Copeland et al. 2002, pp. 27-40; Knorren 1998, pp. 5-10). Whereas the direct impact of the capital market on SMEs will stay low in the near future because of the non-existing quotation of most SMEs, there are indications that especially young entrepreneurs and entrepreneurs of the successor generation are more open-minded about modern financing instruments such as private equity. Consequently an orientation on the requirements of potential external investors and thus an implementation of value based principles is only consistent for those SMEs, for which generating external equity is a realistic option of fund raising. In contrast to the emotionally involved manager-owner, investors see the company as a pure capital investment and will only provide capital if this investment is profitable enough for them (Berens et al. 2005, pp. 117). For this reason VBM can be seen as a prerequisite for generating external equity as it supports a return and simultaneously risk oriented focus of the corporate management.

Another external impulse for implementing VBM in SMEs is the The Corporate Sector Supervision and Transparency Act (KonTraG), which became effective in May 1998. This law commits listed companies in Germany to implement an extensive risk management system. It is assumed that this law will have an impact also on non-listed companies and therefore it will also positively affect corporate management of SMEs in the way that SMEs increasingly take measures to monitor and manage their business risks more intensively. Whether a certain small and medium-sized company actually is affected, depends on the size and the complexity of the individual companies' structure (IDW 1999, pp. 658).

Globalisation, internationalisation, and widespread structural changes across economies are aspects that affect more and more SMEs. These developments cause enormous challenges for SMEs in order to survive or even develop their business (Welter and Havnes 2000, pp. 41). Integrating value based principles in their corporate management generally helps to identify the chances but also the risks resulting from the increasing dynamic environment and helps to stay competitive in the long run in global markets. Following these global trends the International Financial Reporting Standards (IFRS) were established in order to improve the comparability of financial statements of capital market oriented companies and improve the information basis of potential investors. At present the development of reduced IFRS for SMEs is discussed by the International Accounting Standards Board (Baetge 2006). However, the implementation of these SME-IFRS is discussed controversially in the accounting-community. Whereas some authors highlight positive impacts on the man-

agement accounting system of SMEs and the chances for improving the communication with outside creditors (e.g. Müller et al. 2005), other authors question the adequateness of the regulations (e.g. Baetge 2006; IDW 2007). They argue that the costs of adopting the SME-IFRS are too high in comparison to the resulting benefits, especially as the great majority of SMEs does not raise their funds on the anonymous capital markets. Nevertheless, if the SME-IFRS will become applicable law, an increased value orientation of the management accounting instruments will be required.

5.2 Internal impulses

Besides the external drivers of implementing a value-based management in SMEs several internal stimuli can be identified. It is in every owner-managers own interest to incorporate value based principles in his corporate management. We will discuss various reasons for this opinion in the following.

In addition to the external driven motivation of bearing in mind the companies' risks due to the regulations of Basel II and KonTraG, it is also of great importance for the owner-mangers' private financial situation to monitor and manage the economic risks of his business. This perception can be justified because the chosen legal form of the corporation makes most manager-owners liable for their companies' outstanding debts in case of bankruptcy. Even if the firm is led as a limited liability company, the credit granting bank usually asks for personal guarantees, so that the owner-manager assumes liability. In this perspective, VBM serves as a risk management concept turning away the insolvency risk of the company and is therefore necessary for personal financial coverage of the entrepreneur.

VBM can also be understood as an instrument to combine monetary driven economic objectives and the meta-economic objectives of the owner-manager. Because of the strong influence of the owner-manager on the companies' decision making process there is the threat that in the course of time, e.g. after achieving a certain income level, the economic objectives of the owner-manager pale in comparison to the meta-economic objectives such as power or self-actualisation. In their study, SPECKBACHER AND SCHACHNER found evidence that "creating shareholder value" is of subordinate importance in SMEs. The requested companies' rate of return in SMEs clearly lagged behind the rate of return requested in larger companies (Speckbacher and Schachner 2004, pp. 428-429). This development could endanger the long-term survival of the company (Behringer 2004, pp. 14.). In this context, a basic orientation on value based principles could form an antipole to the meta-economic objectives and put the decision-making process within the company on a rational basis.

Without such rationality of corporate management the long-term existence of the company would be in danger and then the targeted self-actualisation of the owner-manager would not be achievable as well.

Many German SMEs face a successor problem because of the age distribution of the owner-managers. The Institute for SME-Research Bonn assumes that in each of the next five years 71.000 German SMEs will have to find a successor (IfM Bonn 2005). Even though other studies come to different findings concerning the exact quantification of the relevant SMEs, they all come to the conclusion that solving the successor problem is crucial for the future success of SMEs.¹⁰ By comparing the number of successions on a European level, one can observe that almost one third of all SMEs will have to face the succession topic during the next ten years, which is therefore far away from being only a German problem (Hohmann 2005, pp. 17-18). Basically three different options exist for the owner-manager to pass his company on: intra-family succession, external succession and separation of possession and management.¹¹ All three options bear certain problems and we will show how VBM contributes to solve or at least diminish these problems.

The majority of the owner-managers are in favour of an intra-family succession as 90% of the owner-managers want their oldest son to take over the family business (Mertens 2003, pp. 284). However due to multiple problems this possibility is realized in only 50% of the cases. Relevant in our focus is especially the fact that the successor generation is less emotionally connected to the company and is more eager to maximize their return (Knorren 1999, pp. 7). By implementing value-based instruments the manager-owner takes first steps into the right direction to ensure an adequate return which might incentivise the son to take over business in future.

If a qualified successor cannot be found in the family, the second option is to find an external successor. The two most common alternatives are Management-buy-out (MBO) and Management-buy-in (MBI), both of which mean that the management as well as the possession of the company is transferred to a third party. After having found an adequate external successor of the company, the purchase price has to be determined. Here, the necessity of a long-term value based corporate management becomes obvious as the companies' value will profit from a long-term VBM. This argument gains in importance by looking at the fact that the portion of successions which were arranged through selling the company increased from 19,2% in 2000 up to 21,1% in 2005 (IfM Bonn 2005).

¹⁰ Differences concerning the exact quantification of the involved SMEs between the studies result from varying SME-definitions. For an overview of recent studies concerning succession in SMEs refer to Hohmann 2005, pp. 16.

¹¹ For a detailed overview concerning the different succession-possibilities see Bruppacher 2005.

If the owner manager wants to keep the possession of his company and decides to appoint an external management, a principle-agent problem might arise. In this case the financial and emotional interconnection between owner and the company stays high as the company usually continues to be the source of the families' income. Because of different interests between owner (principal) and manager (agent) of a firm, the manager might have the incentive to act opportunistic which might cause financial damage to the owner. In smaller SMEs it also remains questionable if the earning power of the company suffices to fund the owner-family as well as the external manager (Mertens 2003, pp. 287). To overcome this divergency and to navigate the managers' actions in the interests of the owner-family, the implementation of a value based incentive- and payment system is proposed in the literature (Happel 2001, pp. 39-40; Keller and Plack 2001, pp. 350; Riedl 2000, pp. 103). Besides these problems concerning the *planned* succession there is also the problem of unanticipated succession because of illness, accident, or death of the owner-manager (Behringer 2004, pp. 148). In these cases a beforehand implemented VBM facilitates to find an adequate successor, without whom the firm would fall into an existential crisis.

6 Implementation barriers

Even though many impulses – internal as well as external ones – exist, to adopt value based principles and behaviour in SMEs, the concept of value orientation is not present to a high extent in German SMEs (Horváth and Mining 2001, pp. 277; Speckbacher and Schachner 2004, pp. 429). The observable lack of diffusion of VBM principles among SMEs might arise from existing implementation barriers, which have to be overcome when thinking of a VBM framework for small and medium-sized businesses. A main problem is the lacking endowment of critical resources in SMEs. Because of their non-academic background many owner-managers do not have the know-how to adopt value-based principles to the needs of their company. As there usually are no supporting departments in SMEs and because of the lack of financial resources owner-managers often have little chances of overcoming this information deficit. Even if they could afford it, many owner-managers are not willing to hark back on external consultants because they see this as a constraint to their decision-making-authority. Those entrepreneurs who already have heard about VBM often connect the Shareholder Value concept to the emergence and downfall of the New Economy at the end of the 1990s (Keppler 2004, pp. 98). The short-term maximization of the stock price is controversial to the long-term company-survival which is one of the main objectives in SMEs. For a lot of owner-managers the strict orientation of all corporate activities on the interests of the investors is not compatible to their corporate social and ethical responsibility resulting from the close relationships to employees, customers, and suppliers.

Moreover, because of limited resources many SMEs do not have adequate reporting- and IT-structures which are needed to implement a complex VBM. The effort to gain the relevant information from the existing accounting systems is immense and requires a certain amount of fiscal know-how which many owner-managers do not have because they are mainly trained in technical skills (Schomaker and Günther 2006, pp. 218). It is also argued in the literature that because of the deep involvement of the owner-manager in the operative every-day business, a costly implementation of information-, planning- and management accounting-systems as well as complex techniques of performance-measurement are not as important in SMEs as they are in larger companies (Hoque and James 2000, pp. 3). Besides, one of the main arguments for implementing VBM in listed companies – the existing of agency costs as a result of the possible conflict of interests between owners and managers – does not count in SMEs, where proprietorship and management lies in the hands of one person (Peemöller and Faul 2002, pp. 306).

Despite these partially comprehensible and traditionally grown arguments of many owner-managers we believe that VBM is an adequate management concept also for SMEs, because the basic principles of this concept make sense for all investments regardless of the size, legal form, or structure of the equity holders. As value orientation targets the long-term profitable growth of a company it perfectly fits to the main objectives of many SMEs such as financial maintenance of the owner-family and long-term independence (Schomaker and Günther 2006, pp. 218-219).

7 Stakeholder Value Orientation in SME versus pure Shareholder Value Orientation in large Companies

In the partially emotional debate on the Shareholder Value concept in Germany detractors of the concept implied that shareholder value means to focus only on short-time maximisation of the stock price. As a consequence many labour representatives argued that the shareholder value concept would implement social injustice and increasing unemployment (Achatz 1998, pp. 14). However, this objection can be overruled as the focus on creating long-term value added is a typical characteristic of VBM (Gleißner 2004, pp. 40). In the literature, there is often given the indication, that VBM-solutions, which are usually tailored for listed companies, principally can be implemented also in SMEs, without discussing the problems resulting from the various specifics of many SMEs (Feldbauer-Durstmüller and Wolfsgruber 2005, pp. 245). As we pointed out earlier, SMEs are integrated in a narrow network of relationships to stakeholders, which is very important for the companies' success and therefore has to be approached with great care. Among others, DONCKELS identifies the special role of non-family close personnel (Donckels 2000, pp. 308). The knowledge, ex-

perience and commitment of important employees present a strength for the company. But simultaneously this aspect might also lead to a strong dependency of the company. Long-term relationships to customers, suppliers, and financiers are also typical for SMEs. For this reason SMEs integrate their stakeholders' demands in their own corporate objectives. This is often an important precondition for the companies' success, and the non-consideration of the stakeholders' interests could lead to extensive economical disadvantages of SMEs (Schmalenbach-Gesellschaft 2003, pp. 525-526). This approach is referred to as the Stakeholder value orientation and complements the sole orientation on the return requirements of the shareholders (Shareholder value orientation). In contrast to the often stated contrariness of the two concepts we agree with COPELAND (Copeland 1994, pp. 103-104) and PAPE (Pape 2004, pp. 41-42 and 152-156) who argue that not only shareholders but also stakeholders profit from a value oriented and sustainable corporate management (Riedl 2000, pp. 128-137). As an example one can think of the employees who benefit in form of job security or banks which in turn benefit from a shrinking insolvency risk of the debtor. It is hardly imaginable that a company can secure long-term sustainability and profitability without keeping in mind their stakeholders' interests (Palli 2004, pp. 41).

In this context KHADJAVI distinguishes between Family Value, Customer Value and Social Value (see Khadjavi 2005, pp. 71-77). In Germany family businesses are especially important,¹² and thus the interests of the owner-family such as legal and economical independence as well as long-term sustainability possess top priority. In view of the dependency of many SMEs on a small number of customers, it is understandable that besides the Family Value the Customer Value Concept is discussed intensely in the literature (see for example Belz and Bieger 2004). The postulated aim to establish sustainable customer-relations to secure long-term value for the company as well as for the customer also supports the aspired securitisation of the long-term companies' existence due to the Family Value concept. Nevertheless the Customer Value is not the dependent variable, which is to be maximized, but it describes an important value driver for SMEs.¹³ Because of the social and regional embedding of many SMEs in the literature the term of the Social Value was established. In their study SPENCE AND RUTHERFOORD show that a remarkable number of owner-managers consciously surrender profits in order to engage socially (Spence and Rutherford 2002). But the established social value often has negative consequences for the private value of the owners and is therefore sometimes negative for other stakeholders like employees or customers (Khadjavi 2005, pp. 76).

¹² „It is assumed that the value of the German family businesses is four times larger than the value of listed Companies in Germany, see Spremann et al. 2001, pp. 49.

¹³ Thus Shareholder Value is the consequence of Customer Value, see Khadjavi 2005, pp. 75.

All in all, the remarks show that SMEs not only have to meet the owner-managers own economic and meta-economic aims but also have to keep an eye on the stakeholders' interests to create long-term value for the company and thus for the owner(-family). Following the Schmalenbach-Approach of VBM for SMEs, SCHOMAKER AND GÜNTHER identify internal and external value drivers which influence the value creation of a company (Schomaker and Günther 2006, pp. 223-232 and Schmalenbach-Gesellschaft 2004, pp.115-122). Internal value drivers serve to achieve the aims of several stakeholders and can be influenced by the company. For example, the equity ratio or the return on assets which are important rating criteria can be identified as value drivers to meet the financiers' requirements. Measures to improve customer retention and product-quality for example create customer value whereas job security and communication of the companies' goals to their staff increase employee satisfaction. Contrarily to internal value drivers, external value drivers have an external impact and cannot be influenced by the company. SMEs have to act foresighted to react to possible changes of the environment and to make sure that the external value drivers will not become risk drivers. In this context, VBM can help to analyse different strategic options and can help to assess the connected profits and risks of each strategy (Schmalenbach-Gesellschaft, 2003, pp. 530-531).

Based on typical characteristics of small and medium-sized enterprises and the thoughts on SME-related value- and risk-drivers, in the following passages we derive criteria to evaluate the adequacy of accounting instruments to pursue a value oriented strategy in small and medium-sized enterprises.

8 Evaluation criteria for VBM instruments in SME

Because of the heterogeneity of the group of SMEs, it is certainly not possible to establish a universal VBM for all SMEs. The specifics of each company have to be taken into account when implementing value based instruments. Because the development of "the one and only" VBM for SMEs is hardly possible, we believe it is more reasonable to derive evaluation criteria, on whose basis the adequacy of several management accounting instruments to pursue and implement a value based strategy in SMEs can be assessed.

First of all, an adequate management accounting instrument should consider value based principles. By this we mean that preferably a simultaneous consideration of return *and* risks should be ensured (Gleißner 2005, pp. 17). However, it might also be possible to use different instruments that are separately return or risk oriented to create an overall compensation of return and risk focus in the

company. Whereas for listed companies it is of great importance to calculate the exact value of a company to identify value gaps or to communicate value added to the investors, in SMEs this aspect is of secondary importance. The exact calculation of a firms' value in SMEs is normally necessary only in the context of selling the firm during the succession.¹⁴ It is rather important that in SMEs the management accounting instruments ensure the provision of decision-relevant value oriented information for the corporate management.

Furthermore, we believe that an unreflected transfer of VBM-instruments used in listed companies is not adequate. As WELSH AND WHITE state “a small business is not a little big business“ (Welsh and White 1981). Specifics of SMEs necessitate a stakeholder orientation of the management accounting system more than a shareholder orientation. This is due to the high degree of interaction of the SMEs with their environment. This leads to the perception, that in addition to capital orientation, social aspects have to be considered as well, when developing a value based management concept for SMEs. Here it has to be considered that especially in small firms the owner-manager is involved in every-day business and interacts closely with his employees, customers and suppliers. For this reason it can be assumed that the stakeholders' interests are already implicitly considered. In larger SMEs where the owner-manager is less involved in operative activities more information concerning the fulfilment of the stakeholders interests have to be generated by a value based accounting. A special focus among the stakeholders has to be put on the capital providers. A revision of the attitude of the traditionally transparency-averse owner-managers is hereby indispensable. By doing so, a bank-focussed, transparent reporting and communication of the (rating-)relevant data is essential to secure the capital procurement and interest rates, which will finally lead to an increasing value of the company. In this context, special emphasis should be put on strategic planning. Besides the positive effect on the rating grade, this modus operandi will activate the analytical examination of the value and risk drivers which is required within a VBM framework. It is essential to regularly evaluate the strategic focus to ensure the SMEs will not constrain their flexibility and adaptability which are important success factors and which mark competitive advantages against many larger companies.

The VBM approach should be derived from a resource-based view of a SMEs endowment with capabilities. Resources are seen as fundamental units of creating value (Achtenhagen and Naldi 2004, pp. 1). Because of limited financial and IT-resources, however, processing huge amounts of data is problematic in many SMEs. The use of complex IT-instruments is often rejected in SMEs as it

¹⁴ However, some authors recommend the implementation of value based performance measures in SMEs to calculate the value added of the firm or to identify value gaps, see e.g. Kartscher and Rockholtz 2002, pp. 175-176.

might lead to inefficiencies due to high implementation and running costs of the necessary IT-infrastructure. The know-how-deficit and the limited endowment of personnel resources especially in the field of management accounting even amplifies the need for easily manageable instruments. As a result of the absence of supporting departments the owner-manager is often the only person who is in charge of management accounting. Therefore VBM should not be too complex or require special skills in strategic analysis or sophisticated information systems (Rangone 1999, pp. 234). It should be possible to generate the information needed from already existing data with only a small amount of necessary adjustments.

On account of the heterogeneous composition of the small and medium-sized businesses the endowment of resources as well as the information demand to manage a company varies among the different SMEs. The exact definition of VBM always has to be made with respect to the individual conditions of a firm. This requirement can be met by establishing a modular concept of value based accounting (Beckmann et al. 2002, pp. 1217). Using such a modular approach allows a stepwise implementation of different instruments and methods which in sum builds a tailored VBM for each SME.

9 Conclusions

The aim of our literature based study was twofold. Firstly, we wanted to analyse internal and external drivers for the implementation of a VBM framework in German small and medium-sized enterprises to show the need for value based ideas in the corporate management also of non-listed SMEs. Secondly, we aimed at deriving criteria to evaluate the appropriateness of value based management accounting instruments and principles for SMEs.

We discovered that external impulses as well as internal motivations of the owner-manager determine the value orientation of corporate management in SMEs. This can be gathered from the need to establish an adequate capital basis which is a basic prerequisite for future development and success of the business. Especially the regulatory changes due to Basel II have a great impact on German SMEs as their capital procurement highly depends on bank loans. In this context we put much emphasis on explaining the deep interconnections between elements of a VBM concept and rating requirements concerning Basel II. By considering value based principles in their corporate management SMEs can improve their rating grade which in turn might lead to an increasing value of the firm. Especially measures to increase the long-term equity basis and to increase the cash flow will have a positive effect. Other external impulses are the increasing internationalisation of many SMEs

and following regulations such as The Corporate Sector Supervision and Transparency Act or the planned SME-IFRS. Impulses for the growing internal motivation among owner-managers are the personal liability for the companies' debts and the resulting need for a personal financial coverage. The conclusion that neglecting value oriented behaviour could also lead to not achieving the meta-economic objectives additionally motivates the owner-manager to implement VBM. Another important internal aspect is the successor problem of many SMEs, which can be solved or at least diminished through value orientation of the corporate management.

Even though many impulses to implement VBM exist, value orientation is not present to a high extent in German SMEs because of existing implementation barriers. Since it is hardly possible to define the "one and only" VBM for the heterogeneous SMEs, we derived a catalogue of requirements for value oriented management accounting instruments in SMEs based on typical characteristics of SMEs and on our findings concerning implementation barriers as well as concerning value and risk drivers of SMEs. Thereby it is essential that the management accounting instruments should not put the most emphasis on the exact calculation of the companies' value but accentuate the need for generating concrete value-based information for the decision-making process. Besides being return and risk oriented a VBM concept needs to consider the stakeholders' demands, which are important value drivers of SMEs. A special focus should be laid on increasing the transparency of the business and improving the communication of (rating-) relevant data especially to the creditors. Their limited internal resource base and oftentimes restricted access to external resources influence the design of possible VBM concepts for SMEs. Especially the limited endowment of critical resources (such as financial resources, know-how, IT-structure) has to be taken into account when developing a VBM concept for small and medium-sized businesses. Therefore, only cost-efficient, comprehensible, and easy manageable instruments should be used which allow a modular implementation of VBM due to specific requirements of an individual SME.

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