

SHORT NOTE**ADDED VALUE AMONG THE FURNITURE
MANUFACTURING SMES**

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ABSTRACT

When policies are defined, numbers, indicators are to be respected. When measuring performance of individual companies, similar applies for entire industries. The challenge is how to evaluate, what source of information can provide reliable and available data? Added value is a potential way to do so, as reinforced by a brief historical overview.

Respecting value added as a measurement tool, the distribution of the Hungarian performance is presented, incorporating foreign-owned and local capital, company size. This snapshot reveals the relatively weak performance of the Hungarian SMEs, especially in the countryside.

As a final step, the Hungarian SMEs added value is under focus, in the furniture manufacturing. Factual evidence is provided that it is not a valid statement that technology-intensive industries by definition create big added value, and labour-intensive industries are lagging behind. An industry-specific strategy with proper subsidy policy can be a way to move competitiveness forward.

KEYWORDS: Added value, furniture manufacturing, SMEs, value chain.

INTRODUCTION

Wood is a natural resource that is a potential sustainable competitive advantage in Central Europe. Relying on this equity diversification of industrial sector can be reinforced. Currently, there is an overestimation of car manufacturing and mechatronics, while furniture industry is often neglected as labour-intensive.

It is essential to provide factual evidence for the added value that can potentially be created by the furniture manufacturing. The paper aims to give evidence on how added value can vary dependant on industrial and entrepreneurial strategies, and not by branches. It means the future of furniture manufacturing is up to us, to bring it to the edge of innovation and value creation.

MATERIAL AND METHODS

Added value, as an indicator for measuring performance, both on individual and integrative level is based on secondary literature research. The added value distribution in Hungary, on geographical and sectorial level is based on data purchased from the Hungarian tax office (2013). Value chain analysis is relying on information from the European Union online database source.

RESULTS AND DISCUSSION

Added value, as performance indicator

Due to the more and more complex and increasing international competition, as a result of the ICT applications development, because of the constant pressure on the pricing, and last but not least to improve the efficiency of the public support schemes, measuring the economic value of the businesses is in the centre of policy focus. This objective is to be realized in a dynamic environment.

The demand for measuring and evaluation grew significantly during the 1990s. In 1991 a publication was released in the Harvard Business Review by Eccles (1991). He predicted in his paper that by the mid 90s each company has to reconsider its methodology of performance measurement.

The labour costs accounted for half of the cost of goods sold during the 1960s, in case of an average business. In the decades this ratio has fallen under 10 % (Neely 1999). In the course of the recent decades, due to the permanently growing share of automatization, it has further decreased. It means that the methodology of allocating general cost – for example weighting with number of employees – could result in totally wrong management decisions.

A logical overview of performance measurement is provided by in his work – ‘An overview of frequently used measures’ (Tangen 2003). In his paper he analysed the application of financial indicators (e.g. margin, return on assets, return on equity), which are criticized frequently due to its nature of short term and historical nature.

In case of many enterprises the activity-based-costing orientation is typical, which can be a major contributor to production efficiency. On the other hand it has less focus on market and consumer orientation. There are productivity indicators – even for the entire portfolio, with respect to time, as well. Part of this latter is the Total Productive Maintenance (TPM), which aims to maximise the utilisation of the assets – ‘sweat the assets’. However, these measurement methodologies are typically industry-specific – like the quoted TPM method, which can be applied in most cases in the strongly automatized branches (Nord and Johansson 1997).

There are obviously challenges in the performance measurement of the companies. It is valid on the individual company level, but even more when the intention is to create integrated indicators – like for judging the performance of an entire industry. Significant task is – beside the selection of the proper methodology – the access to the relevant information. The indicator has to fulfil the criteria that is it based on real, historic data, available in satisfactory amount and reliable way, a proper choice to serve as basis for conclusions and abstracting.

Respecting the expectations the value added calculation and comparison is applied. It is based on balance sheet data, net sales decreased with the cost of goods sold, with direct purchase and production costs. It has to cover amortization, salaries and the owner’s compensation. There are downside of this methodology. Large companies have easier access to finance, their economy of scale reinforces higher labour productivity, at the same management performance as in case

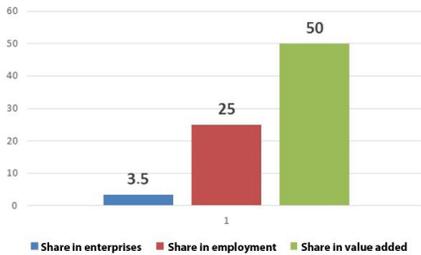
of a small and medium sized enterprise. On the other hand the tendency of the added value, the ratio reveals a significant amount of information about the performance, and enables comparative analysis.

Measuring performance is challenging. The central focal point is if the performance measurement, and the strategic thinking deriving from it results in a higher business performance. There are numerous empirical evidence that in case a company has a strategic management performance evaluation system, than it is more successful than the ones without it (Bisbe and Malagueño 2012). It is explained by that performance measurement enables more efficient execution, communication and monitoring. Quantified objectives play an important role. It is valid on individual company level and on entire industry, as well.

Measuring performance in itself is not the solution, like the objectives and action plans established on it neither. It has to be accompanied with flexible adaptation in a changing environment, otherwise it will be a barrier for the efficiency improvement.

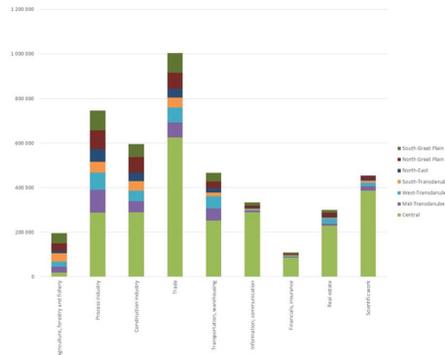
Added value distribution in the Hungarian economy

The economic performance is largely dependent on the capital structure. It is well reflected by the following summarizing chart of Hungary (Fig. 1).



Source: Own calculation based on Hungarian tax office data, 2014.

Fig. 1: Performance of foreign owned enterprises in Hungary.



Source: Own calculation based on Hungarian tax office data, 2013.

Fig. 2: Added value of small businesses in Hungary, by region and by industries.

It means that 3.5 % of the enterprises, that are foreign owned enterprises, create half of the total added value. It is a dominant, characterizing performance.

The following table gives a snapshot, how the foreign-owned enterprises structure is broken-down by industries in Hungary. It is fully in correlation with the added-value distribution by economic branches (Tab. 1).

It also means that when the suppliers' performance is to be improved in the mechatronics sector, it is 87 % fully foreign-owned enterprises. It does not mean by definition good or bad, but has to be considered. These companies have different policies in how to allocate for example research laboratories, flexibility in production reallocation, co-operation with other local players.

A characteristic phenomena is the high geographic concentration of the SMEs' added value. The capital – central region – is leading in the added value for the SMEs in all economic sector. In total half of the value added of the SME sector is produced in Budapest (Fig. 2).

Tab. 1: Share of foreign owned enterprises in Hungary, in the key economic sectors.

	Net sales of enterprises, billion Huf	Share of FOE in the net sales (%)
Computer, electronic and optical production	3 847.40	97.3
Road vehicle manufacturing	4 662.00	96.3
Air transportation	288.60	95.9
Communication	1 047.80	90.6
Electric equipment manufacturing	1 099.90	87.9
Machinery manufacturing	2 835.70	87.3
Metal raw material production	775.20	85.2
Other vehicle manufacturing	128.30	82.4

Source: Hungarian statistical office report (2014).

Summarizing the above facts, the key question is what comparative advantage Hungary – and other Eastern European countries – can give these players to stay and re-invest in the long-run in our countries, and how local SMEs can grow up next to them? The first part of the questions relates to industries like mechatronics, automotive, ICT, while the latter more to the traditional branches.

Value chain in the furniture manufacturing

Hungary has an average density of wood areas, but with respect to the quality of wood for furniture manufacturing, it has a comparative advantage in this type of natural resource. As an evidence, wood export is performing well. Meanwhile the domestic furniture market nearly collapsed – 40 % of the value of 2008 in 2013 –, damaging the furniture manufacturing, while export is stagnating.

The value creation of the supply chain was monitored, based on European Union statistical data. The process goes as follows: Forestry and logging–wood retail – sawmill – furniture production – wholesale – retail.

The comparison is made based on the gross operating rate – gross operating profit divided by net sales, to neutralize the impact of turnover. It can be concluded from the table that in Hungary there is a double squeeze – a high margin on the raw material production side and low prices on the consumer side. The forestry is profitable due to the fact that they have export-capable goods, meanwhile the consumer prices could not be increased due to the low purchasing power (Tab. 2).

Tab. 2: Gross operating rate in the Hungarian furniture industry.

	Forestry and logging	Wood retail	Sawmill	Furniture manufacture	Wholesale	Retail	Consumer price vs inflation
Hungary							
Number of Enterprises		618	722	2 530	288	2 036	
Gross Operating Rate	34.0%	5.5%	6.7%	6.1%	3.7%	3.6%	23.0%

Source: Own calculation based on EUStat database (2012).

The first question is if this is typical for Central European markets in this industry, or it is not a structural issue. When comparing the data with selected benchmark countries and the EU average, it is derived that it would be wrong conclusion to state that furniture industry is by definition low added value sector (Tab. 3).

Tab. 3: Gross operating rate in selected countries, in the furniture industry.

	Forestry and logging	Wood retail	Sawmill	Furniture manufacture	Wholesale	Retail	Consumer price vs Inflation
Hungary							
Number of Enterprises		618	722	2 530	288	2 036	
Gross Operating Rate	34.0%	5.5%	6.7%	6.1%	3.7%	3.6%	23.0%
EU							
Number of Enterprises		38 358	39 633	125 000	24 600	168 350	
Gross Operating Rate		21.3%	7.5%	8.0%	6.5%	6.7%	57.0%
Bulgaria							
Number of Enterprises		109	701	2 101	253	1 875	
Gross Operating Rate	17.0%	17.3%	11.0%	11.4%	6.6%	6.4%	36.0%
Poland							
Number of Enterprises		1 532	5 235	14 295	648	6 004	
Gross Operating Rate	11.0%	10.2%	9.4%	9.0%	9.7%	7.3%	43.0%
Austria							
Number of Enterprises		641	1 053	3 146	282	2 626	
Gross Operating Rate	31.0%	47.9%	4.8%	9.9%	4.8%	5.2%	72.0%
Slovenia							
Number of Enterprises		285	558	1 093	69	208	
Gross Operating Rate	45.0%	3.6%	10.6%	5.4%	4.4%	4.3%	112.0%
Germany							
Number of Enterprises		3 988	2 024	9 316	1 567	17 782	
Gross Operating Rate	24.0%	58.6%	3.8%	8.6%	7.0%	5.6%	41.0%
Italy							
Number of Enterprises		17 660	5 865	18 883	5 845	35 106	
Gross Operating Rate		60.7%	10.5%	6.8%	6.6%	7.6%	88.0%

Source: Own calculation based on EUStat database (2012).

Tab. 4: Gross operating rate in selected Hungarian industries.

	Food industry	Textile industry	Electronic manufacturing	Vehicle manufacturing	Agrar machine manufacturing	Furniture production
Hungary						
Number of Enterprises	4 436	1 091	874	45	161	2 530
Gross Operating Rate	6.2%	6.6%	8.9%	10.8%	8.7%	6.1%

Source: Own calculation based on EUStat database (2012).

Tab. 5: Gross operating rate in selected countries, in selected industries.

	Food industry	Textile industry	Electronic manufacturing	Vehicle manufacturing	Agrar machine manufacturing	Furniture production
Hungary						
Number of Enterprises	4 436	1 091	874	45	161	2 530
Gross Operating Rate	6.2%	6.6%	8.9%	10.8%	8.7%	6.1%
EU						
Number of Enterprises	262 816	60 300	51 000	2 300	7 202	125 000
Gross Operating Rate	7.7%	8.5%	8.6%	6.0%	8.9%	8.0%
Bulgaria						
Number of Enterprises	4 840	583	487		326	2 101
Gross Operating Rate	8.7%	11.6%	9.4%		20.9%	11.4%
Poland						
Number of Enterprises	13 767	4 211	2 076	110	480	14 295
Gross Operating Rate	8.8%	11.3%	10.2%	9.0%	12.0%	9.0%
Austria						
Number of Enterprises	3 421	591	480	27	123	3 146
Gross Operating Rate	7.5%	6.7%	13.6%	9.8%	7.3%	9.9%
Slovenia						
Number of Enterprises	1 248	349	403	18	59	1 093
Gross Operating Rate	5.9%	8.0%	8.8%	6.2%	10.2%	5.4%
Germany						
Number of Enterprises	29 106	3 809	6 127	263	639	9 316
Gross Operating Rate	5.1%	6.9%	6.9%	4.9%	9.3%	8.6%
Italy						
Number of Enterprises	55 203	15 799	9 162	119	1 947	18 883
Gross Operating Rate	7.6%	8.5%	9.3%	3.7%	5.3%	6.8%

Source: Own calculation based on EUStat database, 2012.

Two further questions arise from the above table – are every industries poor performers in Hungary and if furniture production is lower than others in each respective country, as well. The Tab. 4 obviously suggests that furniture manufacturing performance is weaker than any of the other observed industries. Even textile has better indicator than that of the furniture production.

Following this the next step is the comparison of the furniture manufacturing within the other countries. Is it an industrial specialty, to have lower operating rate than for the others? (Tab. 5).

Furniture manufacturing is in the medium range of the respective country performances. It is not by definition – with respect to gross operating rate - realistic to say that there is a determination in any industries or countries to belong to bad or good performers.

CONCLUSIONS

All above analysis suggests that value added gives an in sightful overview not just on the level of the individual businesses, but also on industrial level. When defining the current state of a branch competitiveness, it enables fact based comparison tool.

Looking at the Hungarian SME added value performance and especially the furniture manufacturing dashboard, it leads to the conclusion that challenges do derive partly from the size of the companies – that is a given character -, but it is not valid to say that highly labour intensive and less technology intensive industry has to have lower added value by definition.

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