

SUSTAINED AND BALANCED GROWTH OF A SMALL QUASI-DIVERSIFIED COMPANY: STRATEGIC ASPECTS

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ABSTRACT

This paper discusses issues related to the strategic aspects of sustained and balanced growth of a small company with a quasi-diversified production/market structure. Using a matrix model adequate to the resource and information capabilities of small firms, the contribution of each product set on growth, efficiency and finances of the company is evaluated at first. Then, on the basis of the analysis, specific strategic moves are outlined and the possibility of their realization discussed. A small Bulgarian winery offering a limited assortment of wines on the market has been chosen as an object of this research.

KEYWORDS: *sustained and balanced growth; small quasi-diversified firms; strategic analysis*

JEL CLASSIFICATION: *M21; L26*

1. INTRODUCTION

The sustained and balanced growth is a prerequisite for obtaining high performance in the economic development – both for individual companies and the economy as a whole. It influences, on the one hand, the profits and profitability of companies, and on the other, the overall level of employment and prosperity in the society. That is why, questions related to the achievement of such a growth excite the economic thought for long.

The concrete way to achieve sustained and balanced growth depends on the production/market orientation of the company. In this sense, it is different for different firms, which (this aspect concerning) are generally divided into diversified (multi-product) or undiversified (one-product) enterprises. This paper considers the option of a peculiar hybrid – a company producing different assortments (sets) of the same product, i.e. a quasi-diversified company. Organizations with similar production/market structure, especially small ones, are extremely popular in the agriculture, as well as in the adjacent food processing industry.

The choice of a quasi-diversified production/market structure is strategic. Therefore, the relation between sustainability, balance and strategy of a company will be outlined first. Then, a model for establishing a sustained and balanced growth of a small one-product company with an assortment portfolio will be proposed. Finally, within the strategic analysis, the model will be tested on a specifically selected firm possessing the above characteristics with the aim to identify its future strategic moves.

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2. RESEARCH QUESTIONS, RATIONALE AND MOTIVATIONS

In its core, an accepted strategy of a business organization reflects a chosen combination of new product(s) and/or market(s) and/or technology (/ies). The implementation of a strategy is normally connected with the achieving of a long-term economic goal, such as maximum profit (Ansoff, 1999). To formulate a strategy, one should take into account, first, the state and the prospects relating to external conditions (environment) to do business, and second, internal factors such as corporate organization, management and control, as well as all necessary changes in them (Verboncu & Nicolescu, 2012).

The scope and quality of a strategy depends mostly on the answer to questions such as "where", in what business areas is the company competing now or will be competing in the future, and "how", by what means will the company try to succeed in the competitive struggle (Grant, 2005). The strategies of micro enterprises, for example, have a limited scope as they compete in one market, with one product, produced by one technology. The opposite is true for transnational corporations, as they are companies offering a range of products in different markets. For the majority of businesses a hybrid situation can be established: one or more markets are served by various modifications (sets) of a product produced by one and the same technology, and even from a single feedstuff.

The quality of a strategy can ultimately be judged on how well it is able to provide a sustained and balanced growth. An example for such a goal is the achievement of a certain growth rate, leading to a desired average rate of return in combination with an acceptable risk and minimum deficiencies in the resources needed.

It should be noted that a sustained and balanced growth of non-diversified companies can be achieved in a different way compared to the same type of growth in diversified companies. The sustainability of a simple one-product firm is a function of the timely and rapid product and / or technology innovation, provided that the new product / technology can quickly reach the competitiveness of the existing one and that there are enough resources to launch it. In multi-product companies as well as in companies manufacturing a product range, the sustainability stems from the combination of products / brands located in different phases of their life cycle, and therefore characterized by different growth rates / resource demands.

The object of study here is the small one-product company with a diverse assortment structure. Similar economic entities can be found in various areas of activity, but they seem to be most prevalent in the agriculture-related manufacturing sectors: almost every economic entity there meets those characteristics. The selection of the manufacturing sector has been outweighed by the fact that recently the share of small firms in the total operating enterprises has remained relatively constant (Table 1).

It is known that large firms resist the challenges of turbulent changes in the environment mainly due to the availability of higher resource reserves and options. It is believed that in such circumstances smaller companies can compensate for resource limitations leaning on its immanent inherent flexibility (Năstase, 2009). However, opportunities for greater flexibility can help solving problems of SMEs if being part of a well thought out strategy focusing on sustained and balanced growth. Therefore, the research subject in this paper puts stress on the strategic aspects of planning the activities of business organizations, possessing similar characteristics/focus and aiming to achieve sustained and balanced growth.

Due to the limited size of the paper, the goal will be to present a thought-out strategic analysis and on that basis to outline possible strategic moves related to the development of the specific case of investigation. In order to achieve this goal an appropriate tool will be implemented, namely the "Growth-Effectiveness" matrix model.

Table 1. Manufacturing Industry (Number)

Economic activity	2009					2010				2011					
	Total	Grouping of enterprises by number of employees				Total	Grouping of enterprises by number of employees			Total	Grouping of enterprises by number of employees				
		Up to 9 people	From 10 to 49 people	From 50 to 249 people	Over 250 people		Up to 9 people	From 10 to 49 people	From 50 to 249 people		Over 250 people	Up to 9 people	From 10 to 49 people	From 50 to 249 people	Over 250 people
Manufacturing industry	33056	24709	6210	1828	309	31179	23655	5510	1720	294	30654	23111	5528	1715	300
Share in total (%)	100	75	19	6	1	100	76	18	6	1	100	75	18	6	1

Source: National Statistical Institute (2013) from <http://www.nsi.bg>

The necessity to discuss such ideas is supported by the fact that the role of the strategy in the management of Bulgarian companies is undervalued¹ and in many cases managers are not even aware of the conveniences that the widely used analytical tools can offer to them.

3. THE "GROWTH – EFFECTIVENESS" MODEL

The "Growth– Effectiveness" model is a modified version of the Boston Consulting Group (BCG) matrix. It has been developed with the idea of overcoming the informational resource limitations associated with the use of the BCG model in the practice of planning of the activities of SMEs manufacturing one product in different sets. To note once again, the goal is to draw a picture of the strategic positions of a company concerning manufactured and marketed product modifications, and, on this basis, to identify future strategic moves.

Like the BCG matrix, the "Growth–Effectiveness" model is based on a four-cell matrix positioned within a Cartesian coordinate system. The coordinates of the individual product modifications appear from the combination of the two criteria. Other graphical elements (e.g. circles) showing the current or future "weight" of the product modification in the company's market-financial structure are commonly used, as well.

As a criterion for determining the level of maturity of a product modification within its life cycle of development the indicator "rate of growth" is used. When calculating this indicator data related to the sales of individual product versions from two different periods are confronted.

As a measure of competitiveness of the different assortments on the market the indicator "cost effectiveness" proposed by the German economist M. Zerres (Zerres, 2009) has proven adequate. At company's level it is determined for a chosen period of time by product modifications, juxtaposing the revenue from them to expenses due. This indicator actually replaces the problematic indicator "relative market share" of the BCG, because the information related to the breakdown of market shares by product modifications and individual competitors that it uses is difficult to be provided with the limited resources of the SMEs.

Cost effectiveness is a suitable criterion for two reasons: Firstly, applying consistently the principles of management accounting, this indicator can be calculated using data from the company's internal information system. This gives managers the opportunity to overcome the obstacles connected with the provision of costly external information. Secondly, the criterion "cost effectiveness" is directly linked (through costs) with the theory of the "experience curve", which has provoked the choice of the criterion "market share" as indicator in the classical BCG case. Additionally, the use of the ratio between revenue and costs accurately sticks to the realities in modern business, because it reflects the marketing aspects of the activities and the increasing differentiation of production. (Papazov, 2009b). Besides initiating an alternative criterion for assessing the competitiveness of a product range, the "Growth-Effectiveness" model introduces a new way to putting company's strength on a level with competitors: Instead of comparing with the strongest rival (as in the BCG matrix through the "relative market share" indicator), the parallel here is done between the firm's cost effectiveness and the sector's average value. (This change in the original Zerres's model has been proposed by the authors of this paper. For details, see: Papazov & Mihaylova, 2009.) As a result of the changes made, the frame of the matrix used by the "Growth-Effectiveness" model acquires the following form: (See Figure 1).

		Cost Effectiveness	
		High	Low
Market Growth Rate	Fast-growing		
	Slow-growing		

Figure 1. "Growth-Effectiveness" Matrix
 Source: Papazov & Mihaylova (2009, p.270)

Using the information provided by the managerial accounting for growth rates and cost effectiveness ratios, the coordinates of the different product modifications are calculated and plotted against the matrix. Thus each range falls within one of the above four sub-quadrants of the matrix. Depending on the positioning of each assortment in the grid, the stage within the life cycle of development can be enlightened, and with that – the presence or lack of financial needs.

Additionally, around the points identifying the position of the different product sets in the grid, circles proportional to indicators reflecting the financial position can be drawn. The idea is to illustrate the assortment structure of the company, i.e. to show the "weight" each variety has for the firm. For this purpose, indicators like sales revenues or profits by product modifications are most often used. This paper relies upon the net operating profit after tax (NOPAT) by assortments, because this indicator represents, on the one side, an important part of the company's free cash flow from operation, and, on the other, shows the contribution of each product modification to the company's balanced growthⁱⁱ.

The selected systematic approach makes it possible to quickly grasp the essential aspects of the practiced business and in particular to answer questions like: "What product modifications contribute to 'a higher cycle' of the company's economy and therefore need financial support?", "Which product modifications are in the 'waning' phases of their life cycle and can therefore set

resources free?" and "To what extent behind the depicted symbolism a sustained and balanced growth can be found?"

The answers of such questions require not only to specify quantitative dimensions, but also to refine working concepts. For example, for the needs of the model the sustainability can be considered as a function of the chosen and tailored to the realities of the industry indicator "average growth rate", which in practice means combining assortments that are in different stages of the product life cycle. A balanced state of the circumstances is also related to the life cycle, as the needs of resources for a future progress are largely determined by the development phase of the product range. Additionally, when the radii of the circles depicted in the model are proportional to cash flow oriented indicators generated by different product setsⁱⁱⁱ, a balance can be assumed after adding the surfaces of the figures.

The "Growth-Effectiveness" model has been tested for strategic planning purposes in the Bulgarian manufacturing industry (Milev, 2010). Examples from the service sector have also been made available (Papazov & Mihaylova, 2009). In the following, the model will be used for strategizing in an area, which represents a combination between agribusiness and processing industry, and in particular – in connection with the development of future strategic moves of the studied vine-growing and wine-making cooperative (VWC).

4. SHORT PRESENTATION OF THE ANALYSED COMPANY

The concrete case of study is a small company dealing with production and selling of alcoholic beverages, and in particular a vine-growing and wine making cooperative (VWC)^{iv}. VWC is a small enterprise, because it employs only 15 people. Despite the small number of employees, it is considered the largest cooperative winery in Bulgaria with over 1,100 cooperative members.

The analyzed VWC is located in the Viticulture Region „Danube Plane“, North Bulgaria (Figure 2), an area known for its long lasting traditions in growing of fruits and processing them into alcoholic beverages. It is one of the 25 wineries registered in this wine region, where more than 90% of the businesses in the branch are small and medium-sized enterprises.

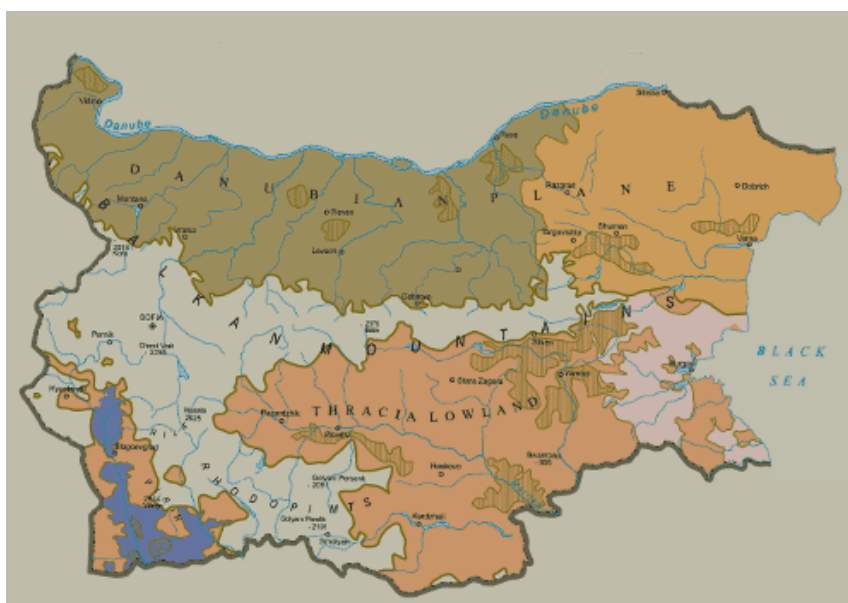


Figure 2. Map of Bulgarian Viticulture Regions

Source: Bulgarian Portal of Wine, April, 30, 2013, from <http://www.bulgarianwines.org>

The VWC produces three groups of wines using a classical technology:

- Red dry wine.
- White dry wine.
- Naturally-sparkling and wormwood wine.

All wines are characterized by rich aroma, fresh taste and quality^v.

The winery works with specific grape varieties typical for the countryside: the white ones („Rkaciteli”, „Dimyat”, „Srebrostruy”) and the red ones („Storgozia”, „Gamza” and „Pamid”) are supplied from the region.

Possessing a minimum space of own vineyards, the VWC is compelled to buy proven varieties after concluding contracts with other vine-growing cooperatives from the region. There are five main purchase points in the villages from the region.

The development of the winery over the years and the problems encountered are of interest because they influence the future strategic decisions. Among the most important development aspects the following can be outlined:

- Diminishing sales due to saturation of markets in recent years (the winery has 180-200 tons of white dry wine "Rkatsiteli" in stock, which can hardly be sold as such).
- Decreasing number of employees (from 80 people in the 1990s to only 15 people now).
- Increasing control measures and requirements to the producers of alcoholic beverages from the state (for example, the obligation to all wineries to install devices measuring the amount and degree of the produced alcohol and communicating it directly to the authorities).
- Inability to attract public (EU and government) funds through participation in announced calls due to betting on unrealistic goals and assumptions (like the objective to increase mid-term sales 3.5 times without taking account of the highly competitive market) in the developed projects.

5. RESULTS FROM THE INVESTIGATION

In this particular research, besides the "Growth–Effectiveness" model, the descriptive statistics method with observations on a concrete object, possessing specific characteristics of a small business from a rural area, with a defined manufacturing product range, and using region-specific resources has been used. Most of the data relate to the period 2010–2011. The data have been derived for a product range pre-defined by the enterprise itself.

An important condition for the construction of the "Growth–Effectiveness" matrix is precisely the existence of analytic reporting of income and costs by product modifications. This allows, on the one hand, to compare income and costs using the "cost effectiveness" ratio for the different assortments, and on the other – to calculate the free cash flow from operations by product sets.

Table 2. Coefficients for distribution of costs by product range in VWC

Indicators	White dry wine	Naturally-sparkling and wormwood Wine	Red wine
Share in sales (%)	18%	39%	43%
Cost correction factor	1.11	1.06	0.90

Source: authors

In the studied enterprise the distribution of costs by product modifications are made, firstly, by taking into account the proportion of each in the total sales, and secondly – by using cost correction factors reflecting the specific requirements for the production of each variety^{vi}. (See Table 2.)

As a result of the calculations made on the basis of the described above methodology, the data for the collected revenues and costs for 2011 concerning the studied VWC can be presented in the following table: (See Table 3.)

Table 3. Annual Costs and Revenues for 2011 by sub-products (BGN)*

Indicators	White dry wine	Naturally-sparkling worm-wood wine	Red wine	Total
Revenues	96660	209430	230910	537000
Operating costs except DA	96806	200499	187695	485000
Earnings before interest, taxes, DA (EBITDA)	(146)	8931	43215	52000
Depreciation and Amortization (DA)	6188	12815	11997	31000
Earnings before interest and taxes (EBIT)	(6334)	(3884)	31218	21000
Financial costs (interest)	3593	7441	6966	18000
Earnings before taxes (EBT)	(9926)	(11326)	24252	3000
Taxes [Tax rate (T) = 0%]	0	0	0	0
Net Income (NI)	(9926)	(11326)	24252	3000
Overall costs	106586	220756	206658	534000
Cost effectiveness (coefficient)	0.91	0.95	1.12	1.01
Net operating profit after tax [NOPAT = EBIT*(1-T)]	(6334)	(3884)	31218	21000

* Company data

Source: authors

Additionally, from official statistical data (<http://www.nsi.bg>) reflecting revenues and costs in the wine producing industry for 2011 an average cost effectiveness coefficient of 1.10 can be determined. There are also published statistics on sales of wine grapes for the period 2010-2011, from which the average growth rate of sales can be derived. It amounts to 7.5 %.

Table 4. Main model data

Assortment	Symbol	NOPAT in t_1 (TBGN)	NOPAT Share (%)	Radius	Growth rate	CE in t_1 (Coeff.)
White dry wine	W	(6334)	(30.16%)	(0.31)	2.8%	0.91
Wormwood wine	P	(3884)	(18.50%)	(0.24)	9.7%	0.95
Red wine	R	31218	148.66%	0.69	7.7%	1.12
Total:		21000	100%		6.7%	

Source: authors

As already indicated, the growth rate of sales can be calculated using the data related to the sales of the individual product modifications from two different periods. Problems for the firm to provide the necessary analytical information in that direction do not exist.

The information by product modifications concerning the sales growth rates, the cost-effectiveness (CE) coefficients and the net operation profit after tax (NOPAT) can be summarized in a table (See Table 4), which gives us the ability to proceed further with the development of the graphical part of the "Cost- Effectiveness" model.

Ultimately, the adapted analytical matrix for the VWC filled in with all graphical elements acquire the following form: (See Figure 3.)

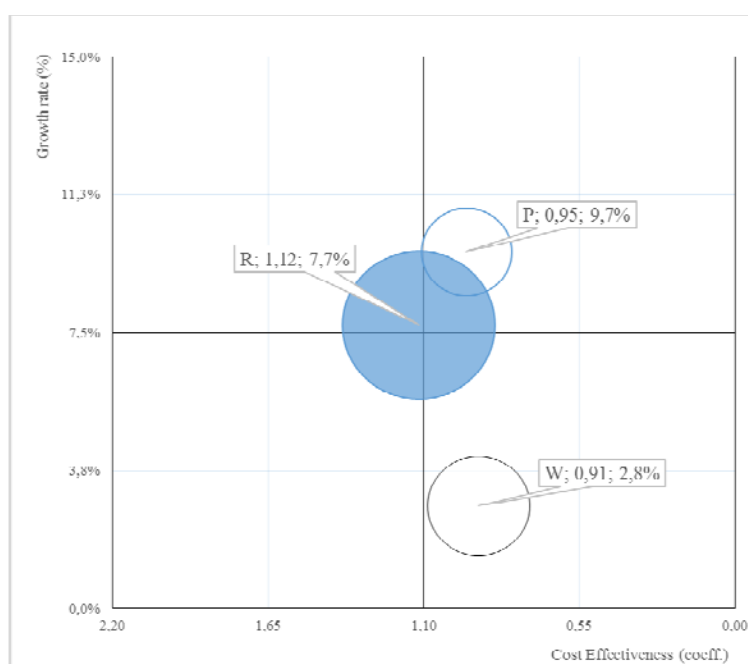


Figure 3. Matrix „Growth – Share” of the VWC

Source: authors

A cursory look at the results of the study will ascertain that the product modifications "Naturally-sparkling and wormwood wine" and "Red wine" show growth rates higher than those of the industry, but the cost effectiveness of the red wine only is higher than the branch average. And if this can be grasped as normal for the wormwood wine since it is a relatively new modification in the product range of the company, the reasons for the poor performance of the white wine are deeper and are probably related to the price-quality of the assortment offered to the market. A consequence of the disappointing results from the performance of the white wine on market is the increased stock from unrealized quantities, mentioned above.

Moreover, thanks to the bad performance of the white wine on the market the company does not reach the average values for the industry in terms of growth rates and efficiency (see Table 4). This suggests some instability and imbalances in the development.

The relatively accurate scale of the imbalances can be seen from the free cash flow of the company as a whole. The free cash flow can be calculated in the manner presented in the following Table 5 (Ehrhardt & Brigham, 2013):

Table 5. Data for the calculation of the free cash flow of the enterprise

(+) Net operating profit after tax (NOPAT)	21000
(-) Change in net operating working capital (NOWC) ^{vii}	137000
(-) Change in net investment	(66000)
= Free cash flow	(50000)

Source: authors

For the calculation of the VWC's free cash flow aggregate data from the company's balance sheet on 31.12.2011 have been used (Table 6).

Table 6. Aggregated balance sheet items for VWC

Assets	2011	2010
Non-current assets	425	522
Current assets	1138	994
Deferred expenses	0	0
Total assets:	1563	1516
Equity and Liabilities	2011	2010
Equity	1340	1352
Liabilities, incl.:		
Non-interest-bearing liabilities	37	12
Interest-bearing liabilities	167	115
Deferred income	19	37
Total equity and liabilities:	1563	1516

Source: authors

The calculation shows that the generated free cash flow amounts to (–) 50 000 BGN, and the main reason are the big investments in working capital, which – despite the positive NOPAT and the money reimbursed from investments in fixed assets – remain uncovered by the mobilized funds.

Disturbing in this case is also the fact that the main "merit" to partially offset the resources invested in working capital is attributed to the reduction of company's fixed assets and not to the flow of funds from the usual business. However, it can be assumed that as the time goes by the first source is doomed to "dry".

Therefore, to outline strategic moves that foresee an increasing share of the NOPAT in the free cash flow of the company becomes indispensable. When preparing such moves one should take into account the contribution of the different assortments in the NOPAT first.

Let us go back to Figure 3 for a moment. The dark circle plotted in the matrix is an expression of a positive NOPAT. In this case, it refers to the assortment "Red wine". The bright circles represent a negative NOPAT and are attributed to the "White wine" and "Naturally-sparkling and wormwood wine". The logical conclusion is that the emphasis in the future should be placed on promoting sales and / or increase in production efficiency of the red and wormwood wine. An introduction of a new product on the market should not be excluded, too.

The following steps have both organizational and conceptual nature: on the one hand, the development and the presentation of the different options in detail; and on the other hand, giving a meaningful response to the various issues that arise in the course of the strategic planning. Exemplary questions and answers in this direction can be found in the following Table 7.

Without rejecting *a priori* each of the strategic moves, the most realistic one at the moment seems to be the move connected with a change in the existing structure through expanding the production of aromatic wines. On the one hand, the wormwood wines have good reception among consumers (wine forums are full of recommendations in this regard). On the other hand, the aromatic wines are to some extent in a position to "melt" the accumulated stocks through inclusion of the white wines in the manufacturing process, thus increasing the production of white wormwood wines. In this way, the decline in sales of traditional wines can be offset quickly and easily. Not ignored should also be the fact that this strategy relies on a resource (i.e. the specific regional sorts of grapes) that provide main competitive advantages.

Table 7. Alternative strategic decisions

Alternatives	Question Marks
Increase revenue while maintaining the level of costs.	Is this a probable scenario having in mind the saturated Bulgarian wine market?
Keeping the level of revenues, but reduce the level of costs.	Can this decision be implemented provided that: <ul style="list-style-type: none"> • Employees of the winery have been reduced to the "healthy" minimum? • There are increasingly growing requirements from the state for deployment of measuring instruments (which requires money)?
Simultaneously increasing the level of income and costs.	Is this option realistic, given the demand has shrunk and the proposed projects for public investments in the company have been rejected?
Introducing a new product modification, such as production of brandy (sub-product innovation).	Can the small winery meet the specific licensing regime established in the country for spirits?
Change in the current structure of the product range.	Can the increase in sales of some of the product modifications compensate for the drop in sales of others? Will the industry average values for growth and cost efficiency be reached?

Source: authors

However, all this will seem reasonable, if the levels of sales of the base product, the red wine, are maintained as they are (or better). In this sense, the strategy of growth applicable to the star product wormwood wine, should be applied together with the strategy of retention of the "cash cow" segment of the company – the red wine.

6. CONCLUSIONS

The strategy analysis based on the "Growth–Effectiveness" model seems to be a relatively simple one, but at the same time it provides occasion for serious considerations on the directions of the future development of a company. It can be improved by way of inclusion of forecast elements associated with both the assessment of the likely changes in sales and cost efficiency in the sector, as well as with inclusion of alternatives referring to existing or future product modifications. This will lay the foundation for a further refinement of the trajectory of change in the product-market orientation of companies and thereby ensure a sustained and balanced growth of small businesses with quasi-diversified structure.

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ⁱ According to a study conducted several years ago by the SME Agency, only 6.5% of managers in Bulgaria believe that maintaining and enhancing the competitive position of the companies they represent, is in some way connected with knowledge and skills in strategic planning. For details, see Article (2003).

ⁱⁱ The usage of the free cash flow itself is also possible, but requires additional technical and technological efforts to distribute investments in fixed assets and working capital by assortments.

ⁱⁱⁱ Since it is not possible to plot radii proportional to negative numbers, the absolute values of the numbers can be taken. To show a "negative" area, a different color can be used.

^{iv} The full name of the cooperative is VWC "Grozd", Karaysen, Bulgaria.

^v According to Art. 8. (1) of the Wine and Spirits Law, a quality wine, coming from a particular region, is the wine originating from a viticulture region, sub-region or vineyard, and which name is used to describe the wine that is produced and treated in the designated region, sub-region or area. Its attributes or characteristics are essentially or exclusively due to the geographical environment, including natural conditions and production traditions.

^{vi} For example, the manufacturing of white wine requires extra peeling of the grapes, while the production of wormwood wine demands additional herbs. All this aggravates the production costs of these sets.

^{vii} NOWC = - (Current Assets + Deferred Expenses) + (Non-interest-bearing Liabilities + Deferred Income)