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## The importance of profitability in managing a small enterprise

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### ABSTRACT

For the whole economy and the mechanisms that take place in it to be effective, it is necessary to develop the small business sector. Its dynamic impact on the economy manifests itself in active reference to changes taking place in the environment. In terms of the constantly changing consumer preferences and their new requirements, it is the smaller companies that stand out with greater ease of adaptation. One of the most important measures of the assessment of the country's economic growth is both the opportunities and the number of small enterprises.

**Keywords:** business, small enterprise, types of enterprises, foreign capital, profitability, types of companies

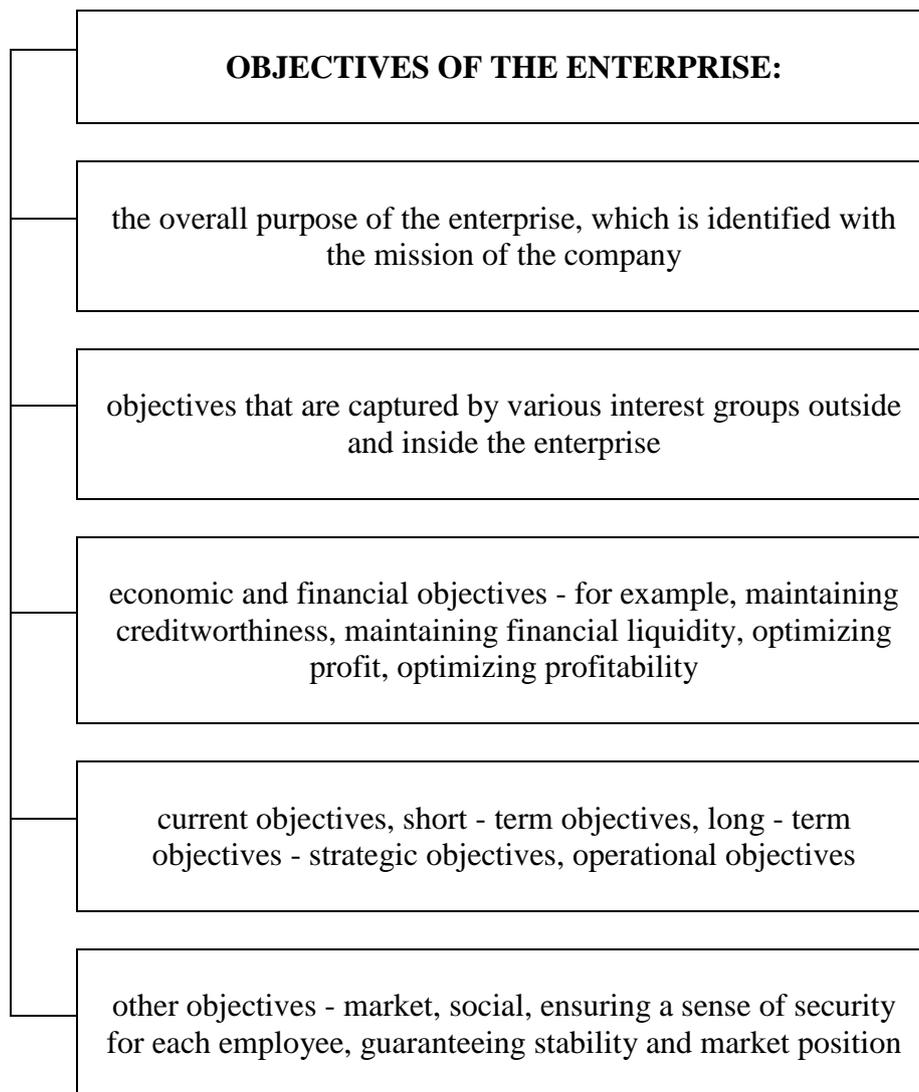
### 1. INTRODUCTION

The financial area is often distinguished by resource scarcity with parallel, insignificant access to the counteroffer that comes from the financial market. The financial area strongly defines the management cycle of small enterprises. These spheres significantly affect the ability and scope of undertaking research and development activity, which in small enterprises is often subconscious. In many respects, proper management in small enterprises is more

important than in the case of large enterprises. High financial losses may lead to small enterprises having a problem to go straight again.

## **2. ACTIVITIES OF A SMALL ENTERPRISE**

In accordance with the characteristics of capital and the economic substance, the main goal of the company is to optimize its value. Achieving this optimization is possible thanks to the acquisition of a small profit from the capital that has been invested. By optimizing the value of a given company, it is possible to pursue other goals. We are talking about a bunch of goals, which can be a prerequisite for making sound decisions in the company. The way of formulating the company's goals is presented below. [6]



**Figure 1.** Formulating the company's objectives.

Source: Own elaboration

In this approach, the optimization of the value of a given company is the key strategic goal. This goal is also the main goal that entrepreneurs assume. [9]

In the profitability ratio, profit is compared to equity, assets and revenues. Through the radical use of capital, it makes it possible to compare the ability to generate profit. [2] Profitability is one of the most important determinants that presents the effectiveness of business management. Among other things, the optimization of profit results from the fact that the systematic generation of income provides a sense of stability, and the enterprise does not have to use foreign sources of financing. To a large extent, the amount of income determines the developmental and innovative perspectives of the enterprise, reducing costs associated with production, as well as the creation of new jobs. In the market category, the company's trump card is identified with the desire to increase its position in the environment of opponents and market position.

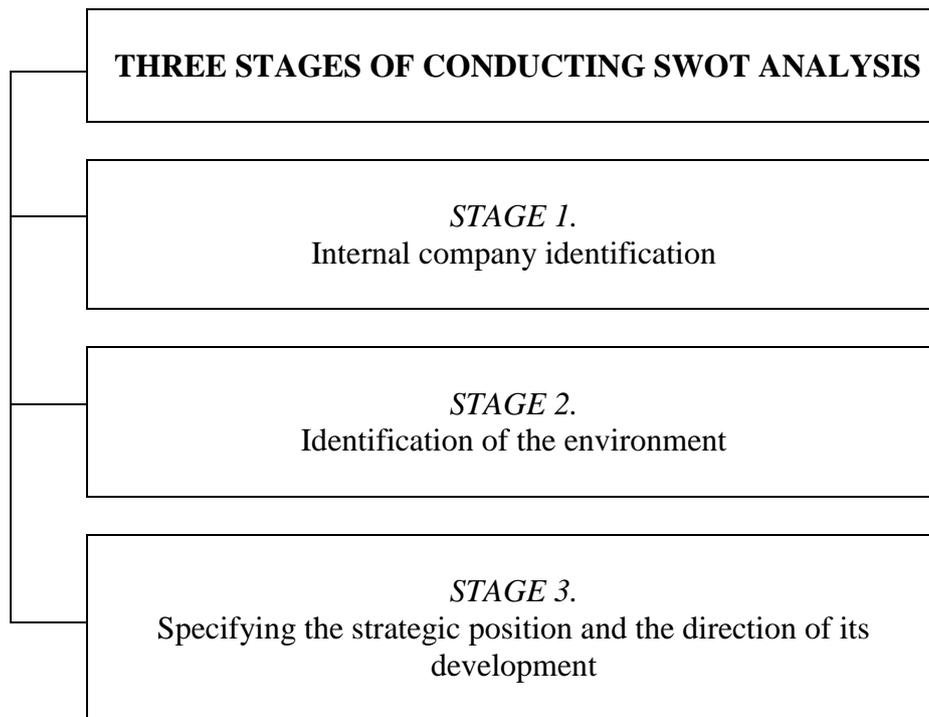
It should be remembered that competition is the driving force, and the market has an impact on the company to keep growing. An achievable strategic vision should be created that is appropriate to the long-term position on the market. It should take into account the interactions that occur between the effectiveness of the environment and the enterprise. During planning, research methods are important. An example of such a method is the SWOT analysis, which enables determination of strengths and weaknesses as well as threats and opportunities that occur in the environment. [4]

	<i>positives</i>	<i>negative</i>
<i>inside</i>	STRENGTHS	WEAKNESSES
<i>outside</i>	OPPORTUNITIES	THREATS

**Figure 2.** SWOT analysis

Source: Own elaboration

SWOT analysis can be applied in the individual spheres of an enterprise, but the analysis may also apply to the entire enterprise.



**Figure 3.** Stages of SWOT analysis  
Source: Own elaboration

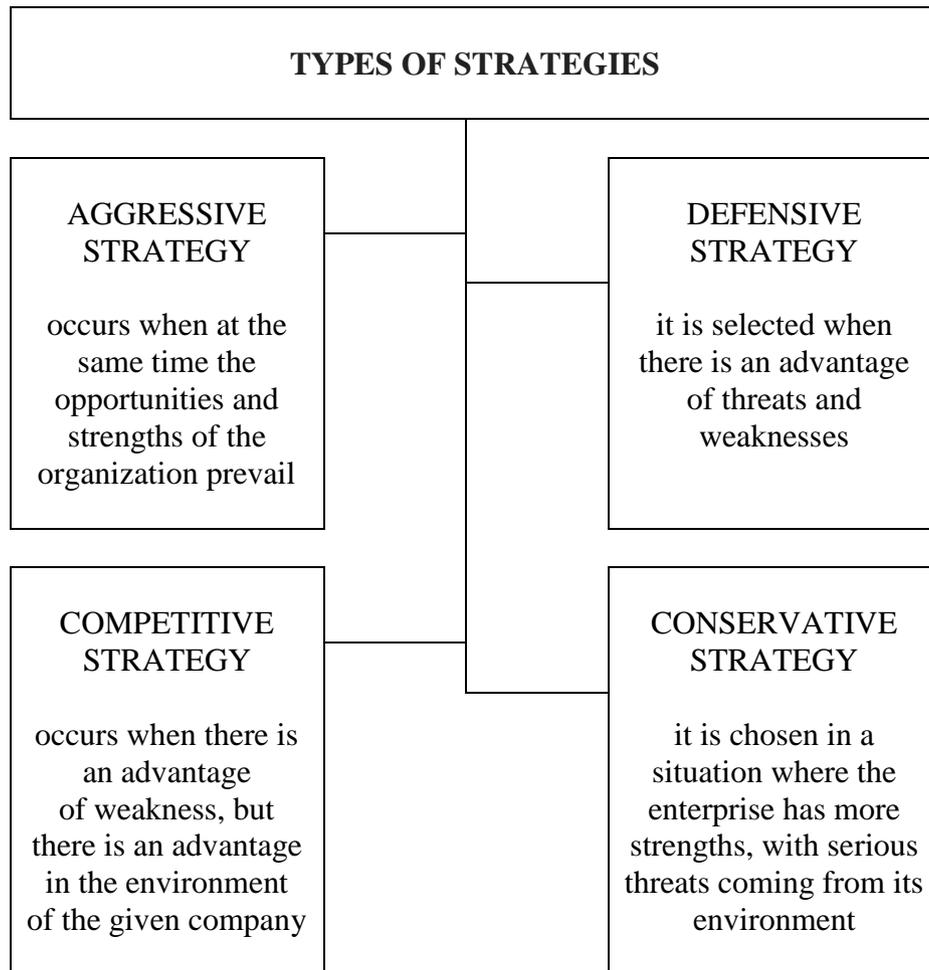
The general set of orders that result from the SWOT analysis is a set of actions that should be taken by the management in each model. These activities include strengthening strengths and excluding weak people and taking advantage of opportunities and reducing possible threats. [8]

While strengthening strengths and excluding those weak, management should focus on identifying and eliminating the weaknesses that most adversely affect the effective functioning of the enterprise. Both the observation process and the process of recognizing the operation of the interior of the organization should not be interrupted.

In reducing possible threats and taking advantage of opportunities, the occurring threats usually directly and quite quickly affect the effective functioning of the organization. For this reason, it is necessary to create protective barriers, both human, financial and material, which protect the company against the negative effects of threats. [11] When it comes to chances, they require taking specific actions so that their positive impact is noticeable for the organization. In order for these opportunities to be used, a permanent system of their observation should be introduced, and the inevitable internal objection should be limited before implementing modifications in the organization. [7]

When considering strengths of an enterprise, managers should observe and recognize them operatively. The need to intensify them is due to the fact that it is much easier to improve something that works well than to try to fix something that does not work.

It is also important to prepare a set of achievable actions that seek to achieve previously defined strategic goals of the company. The right strategy is selected by adding together the number of threats and opportunities as well as weaknesses and strengths. Next, there is a clarification of potential, possible and feasible strategies of the proceedings. The types of strategy are presented below. [10-20]



**Figure 4.** Types of strategies  
Source: Own elaboration

When using the SWOT analysis, it should be remembered that the presented strategies are selected for the entire enterprise. Nevertheless, there is a situation when it is necessary to adjust the strategy of action to a specific combination of individual factors.

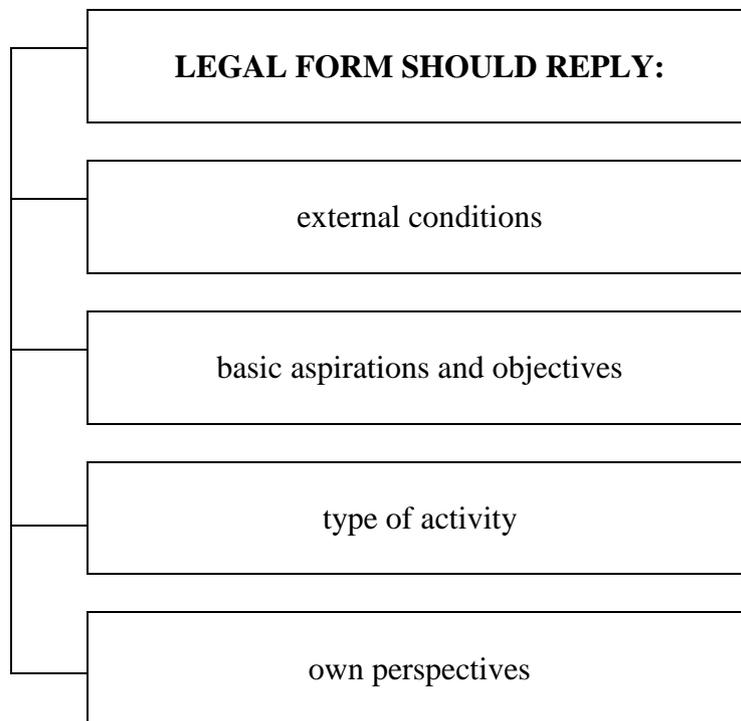
The SWOT analysis is a generally used and well-known method that occurs in strategic business analyzes. The usefulness of this analysis results from the fact that it allows to spot those factors on which the given company is not enough, that it may affect which company should be focused on. It also makes it possible to spot factors that are not dependent on the company and which should be considered when building a strategy.

The SWOT analysis indicates the place where the analyzed enterprise is located in the environment as well as the developmental abilities available to that company. [12] In addition, considering both risks and opportunities ahead of time, this analysis gives the company the time it takes to prepare the necessary preparations. The SWOT analysis also allows focusing on the most important factors that affect the operation of the company. And the analysis guidelines create the omission of possible threats, exploiting opportunities, basing on strengths and increasing the weaknesses of a given company. [7]

Considering the preparation of individuals who are responsible for conducting the analysis, it can be difficult or really easy. In addition, the SWOT analysis can show those things that were previously unnoticeable.

The main disadvantage of conducting the SWOT analysis is the subjectivity of assessing individual factors. It should also be remembered that in the situation of using the simplest version of this analysis, it does not always produce results that we would expect.

It should be noted that the state imposes burdens that contribute to the involvement of financial resources. Taxes include taxes. They are an important factor that causes expenses in the company. On the other hand, the increase in expenditure affects the financial liquidity of the enterprise. When defining tax management goals, it should be remembered that they must have the same key objectives, that is optimizing the benefits of owners and optimizing the value of the company. [1]



**Figure 5.** Legal form

Source: Own elaboration

The most important tax management goals include the maximum tax structure and maximizing their size. In the legal aspect, the maximum amount of taxes should be

understood as the necessary amount that does not expose business to fines. By contrast, the structure of taxes should be understood as the internal construction of a kind of whole, in such a way that the total sum of tax burdens is correct.

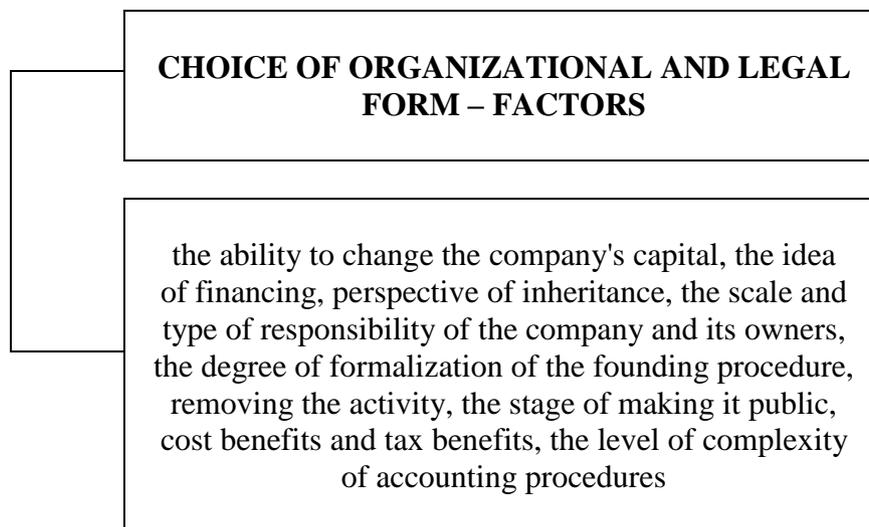
An important goal is also to reduce tax expenditures. This is related to the benefits that form part of the tax shield allowing to define the impact of tax phenomena on separate economic phenomena that take place in the enterprise. [5]

In the situation when the actions initiated bring the maximization of the amount of taxes paid, the enterprise reduces expenses, increases the financial surplus, gains an auxiliary source of financing, thus repairing financial liquidity. [3]

In managing the finances of business operations, the appropriate selection of organizational and legal forms is very important. The choice of this form determines not only the standards of financial management, but also the financial system. This has an impact on the manner of drawing up equity and potentials for obtaining foreign capital.

Making decisions as to the choice of organizational and legal form is not simple, because it merges the individual goals of the entrepreneur with a feasible assessment of the ability and external conditions. [6]

The factors that influence the choice of organizational and legal form are presented below.



**Figure 6.** Factors that affect the choice of organizational and legal form.

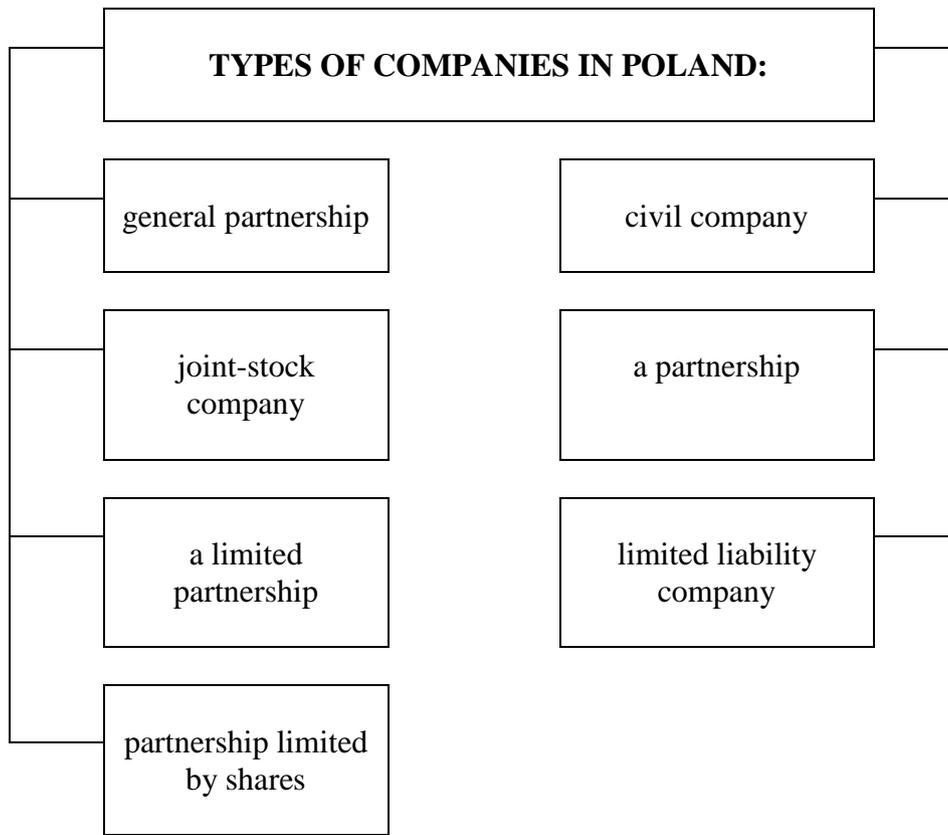
Source: Own elaboration

People who want to start a business can do it as a legal person, an entity that has no legal personality or as a natural person. In such a situation, it appears as an economic entity whose subject of activity is business activity. The company carries out economic tasks and, in addition, carries out postulates related to work safety. The company refers to building regulations, regulations related to environmental protection, fire and sanitary regulations.

In Poland, an enterprise may act as a civil partnership in which the liability of co-owners is loyal and is not limited, as a commercial partnership (general partnership, partnership, limited joint-stock partnership, limited partnership), as a sole proprietor, which

was established under the Act on business activity or as a commercial law company (limited liability company, joint-stock company).

The owner manages and represents his own business. He is the sole owner of the total profit of the enterprise. In addition, the business owner is liable for all benefits that could be settled from his private property. Both the establishment of such an enterprise and its solution is not complicated. It is a proper form for small enterprises that do not require significant investments.



**Figure 7.** Types of companies  
Source: Own elaboration

Limited liability company has legal personality, which is acquired upon entry into the register. The contract of this company requires the form of a notarial deed and is subject to entry into the National Court Register. In addition, the company combines the characteristics of partnerships and commercial companies. The company is present not only in foreign but also domestic sales. The company operates based on share capital. It should not be less than PLN 5 000, and the nominal value of shares should not be less than PLN 50. The company may incur liabilities on its own behalf.

In many respects, a general partnership resembles a civil law partnership. The company has no legal form. The articles of association should be concluded in a written form under pain of nullity. The company is subject to mandatory registration in the National Court Register. It is usually created by only a few co-owners. Each of them brings his own capital.

The company is regulated by the provisions of the Code of Commercial Companies. The company name is required to provide the name of at least one of its partners.

The oldest form of the company is a civil company. It is an uncomplicated form of organizing business activity. This company is not a legal entity. The legal entities are individual co-owners, because each of them has a separate entry in the business register. The company is founded on the basis of a contract concluded between its partners. Shareholders make capital or non-monetary contributions. Each co-owner acquires the same right both for making decisions and for representing his company outside the company. In addition, each co-owner has the same income rights. All liabilities of the enterprise, co-owners, regulate their achievements.

Taking into account all types of companies, the most complex form is definitely a joint-stock company. The company is a legal person. In addition, the company is required to keep accurate accounts. The management board of the company, which is appointed by the supervisory board, has both to represent it and to manage its rights. The company's capital should not be less than PLN 100 000. The company's status must be created in the form of a notarial deed, of course under threat of invalidity. The described company may acquire capital through bonds and on the stock exchange. It is worth mentioning that none of the shareholders of the company is responsible for the liabilities of the company. However, this kind of organizational form is aimed at corporations and large enterprises. This is due to the obligation to systematically use the help of lawyers, legal advisors, professional accountants, as well as due to the relatively high degree of legal and tax difficulties.

Another type of company is a partner company. The company is not characterized by legal personality, but it is equipped with the ability to act in law. It is a commercial law company, which is intended for the management of activities by persons who perform free profession, for example doctors or lawyers.

A limited partnership is a different type of commercial law company. Her personal character is formed by the relatively long-term composition of the staff and the lack of independent bodies that run the company's affairs. Including this can also be the personal characteristics of individual partners. This company is an organizational unit that does not have legal personality. The Commercial Companies Code, on the other hand, gave it legal subjectivity.

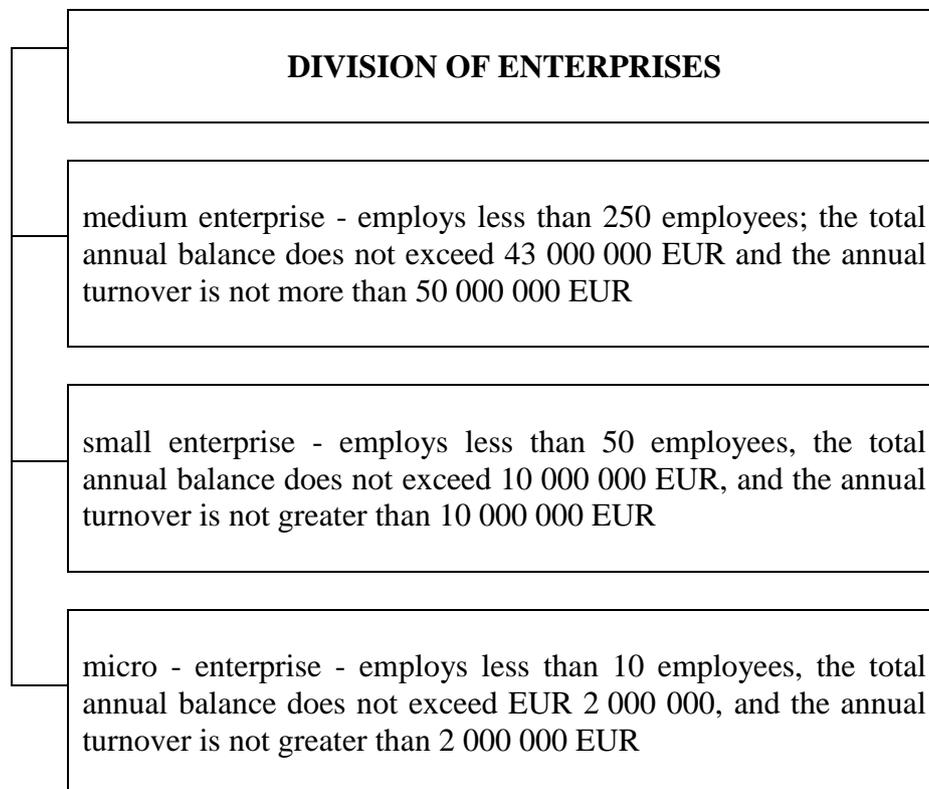
A limited partnership can therefore buy rights on its behalf, including property ownership. Also other substantive rights, as well as incur debt. The law also allows such companies to be sued and sue. The company runs a company under its name. A characteristic feature of limited partnerships are the categories of partners. Complementaries and limited partners are distinguished. The main factor determining the legislator's specification of two types of co-owners is different personalization of their legal situation in the discussed company. Co-owners in can be legal and physical persons, as well as organizational entities that do not have legal personality. They must, however, have the legal capacity given by the law. A limited partnership is recognized when it is entered in the Register of Entrepreneurs of the National Court Register. The company's agreement should be signed as a notarial deed. There are two types of partners in the limited joint-stock partnership. The general partners are responsible for running the company and obligations. And shareholders hold shares of the company, which give only the opportunity to get some profits. This form of company management is very beneficial due to the ease of gaining capital for the growth of the

enterprise. At the same time, the company may retain influence over the decisions made. The most important aspect of the analyzed company is the insurance before the takeover.

Certain situations in which these specific features work more or less determine the choice of organizational and legal form. Capital companies prevail, when both the dynamics and the scale of operations are large, and the share of co-owners is not often of a direct nature. On the other hand, in order to develop activities for not too large scales, personal partnerships are most often assumed. [3]

### **3. REQUIREMENTS OF A FINANCIAL ECONOMY IN A SMALL ENTERPRISE**

As a rule, small enterprises are considered to be the basic element of the economy. Even in the period of globalization, mergers and mergers, their social or economic importance is not trivialized. With the growth of the importance of small enterprises, interest is increased not only in the specificity of management, but also in the interest in development considerations and character. Both for practice and management theory, the effort to clarify and highlight the concept of a small enterprise is important. This is due to the fact that, compared to other larger business entities, small enterprises are distinguished by a certain kind of specificity.



**Figure 8.** Types of enterprises

Source: Own elaboration

Small enterprises have weak and strong sides. Selected ones are presented in the next figure. The weaknesses of running a small enterprise include the lack of the possibility of putting into circulation own shares, as well as the increased difficulty in financing operations, than is the case with large enterprises. However, the decisive advantage of running a small enterprise is innovation, the ability to adapt to the prevailing demand, simple and understandable organizational structure, as well as a fast decision-making process.

<b>STRENGTHS</b>	<b>WEAKNESSES</b>
low production costs, rapid development, high dynamics, the ability to quickly change the type of business	price competitiveness, low economic efficiency, low investment level, the predominance of micro enterprises

**Figure 9.** Weaknesses and strengths of a small enterprise  
Source: Own elaboration

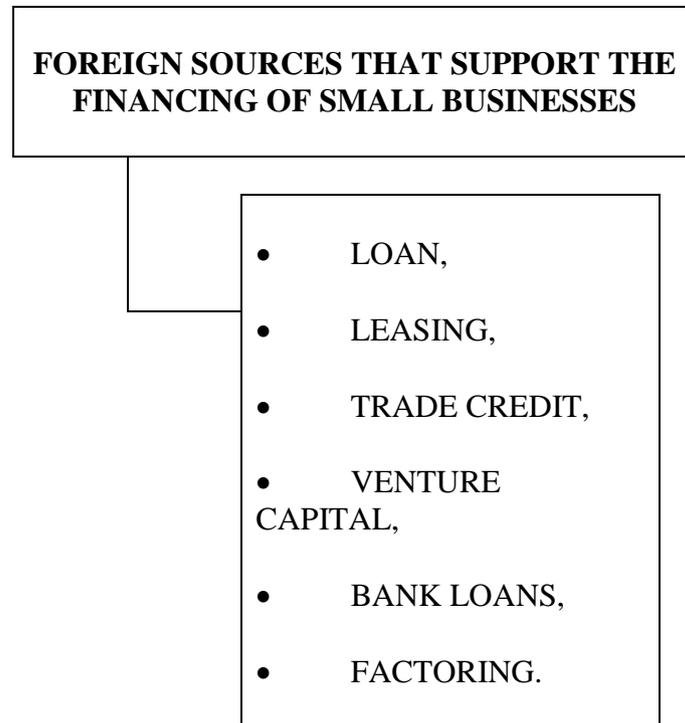
$$\begin{aligned}
 & \text{COST OF FOREIGN CAPITAL OF A LARGE ENTERPRISE} \\
 & + \text{PREMIUM FOR A HIGHER RISK - BONUS FOR AGENCY} \\
 & \text{COSTS A LARGE ENTERPRISE +} \\
 & \text{PREMIUM FOR THE COST OF ASYMMETRY OF} \\
 & \text{INFORMATION ON SMALL AND MEDIUM ENTERPRISES =} \\
 & \text{COST OF FOREIGN CAPITAL SMALL AND MEDIUM-SIZED} \\
 & \text{ENTERPRISES}
 \end{aligned}$$

**Figure 10.** The cost of foreign capital for a small enterprise  
Source: Own elaboration

Mainly, the owners of both small and medium-sized enterprises pay their own equity. At the beginning of the business, the owners use the saved money, while in the later operation they use the retained profits. Owners are reluctant to use foreign capital, because they are

afraid that they will not be able to make it and will become dependent on foreign capital. [6] For a small enterprise, the impact on the cost of foreign capital has less information, an agency conflict that stems from the owner's need to observe the board, and a higher risk by which a relatively higher risk of financial problems can be understood than for larger ones entities. [5]

Financial institutions do not want to give loans to small businesses that are just starting their business or have a crisis situation. It should be mentioned that small enterprises use a small part of the available sources of financing.



**Figure 11.** Foreign sources  
Source: Own elaboration

Factoring, leasing and venture capital belong to modern forms of financing that are available for small enterprises. As of today, factoring is the most flexible, sought-after and also the fastest-growing financial service. Factoring consists in the purchase by the Factor of receivables, their management and financing. The premise of factoring is the perspective of paying the recipient before receiving the benefits from the recipient.

Leasing is a popular method of financing investments. In particular, he is in demand when financing small enterprises. It is a contract under which the provider grants the right to use the asset for a fixed period of time in return for payment. Therefore, leasing should be understood as a type of loan in which specific assets are subject to financial resources.

Venture capital is a long-term and medium-term investment in non-public enterprises that are at an early stage of development. Venture capital is a venture capital, because the doubts of the described form of financing arise from the fact that funds that are entrusted by a

larger enterprise to a smaller enterprise are not in the form of a loan. This is a type of investment that should bring decisive benefits to both one and the other party.

Traditional forms of financing include a loan, a bank loan and a commercial loan. In financial policy, both loan and bank loans play an important role. Due to the relatively poorly formalized procedure, micro-enterprises use loans more often, while larger enterprises use bank loans.

Due to the costs, the buyer's credit has become a fairly competitive, non-banking way to finance business operations. There are two types of this loan: the supplier's credit and the recipient's credit. We talk about the supplier's credit at the time of the supplier's deferred payment for services and goods. The supplier of goods, services or a producer is then the lender. In this case, the payment deadline is postponed a few or even several dozen days. However, the recipient's credit arises at the time of prepayment. The manufacturer has not yet produced a particular good, and the buyer has already paid for it.

#### **4. SUMMARY**

Small entrepreneurs who use sources of financing should consider optimization of the debt structure. When choosing a particular form of financing one should not forget about the economic cost of obtaining capital, taking into account both the alternative costs and direct costs. Attention should also be paid to the amount of risk which is measured by the irregular interest rate and the prospect of a change in the date of repayment of the debt.

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