Proposing a Conceptual Framework for the Study of SME Success in Service Industry: An Appraisal of Theories

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Abstract

The objective of this article is to review the extant literature on the factors contributing to the success of Small and Medium-sized Enterprises (SMEs) operating within the service sector. SMEs constitute a significant component of all economies, with the service sector comprising the largest segment of SMEs in most countries. Given the diverse nature of SMEs within the service sector, this appraisal of theoretical work may help researchers and practitioners alike to have a better understanding of SME success factors to inform strategies not only in this sector but also for other sectors of the economy, including but not limited to the industrial sector, financial sector, and manufacturing sector.

Keywords: SMEs; success factors; service sector; strategy; theories

1. Introduction

The primary aim of this article is to conduct a comprehensive review of the existing literature concerning the determinants of success for Small and Medium-sized Enterprises (SMEs) operating within the service sector. SMEs constitute a vital component of global economies, with the service sector serving as the predominant domain for SME activity across nations. Given the heterogeneous nature of SMEs within this sector, this review seeks to provide insights into the theoretical underpinnings of SME success, offering valuable guidance for both researchers and practitioners. Moreover, the implications extend beyond the service sector, potentially informing strategies across various segments of the economy, including but not limited to the industrial, financial, and manufacturing sectors.

Success is a central aspiration for all SMEs, yet divergent perspectives exist between SME owners/founders and researchers regarding its definition. While conventional wisdom once equated success solely with profit maximisation, contemporary scholarship acknowledges a broader spectrum of success metrics, encompassing both financial and non-financial dimensions. This divergence underscores the complexity of defining and measuring success within the SME context, challenging researchers to move beyond simplistic frameworks and delve deeper into multifaceted evaluative criteria.

Previous research has predominantly focused on quantifiable performance measures to assess SME success, often treating SMEs as opaque entities. However, emerging literature acknowledges the importance of considering non-financial goals and stakeholder interests in defining success, particularly for small businesses. This shift in perspective underscores the
need to explore a broader array of success factors, both internal and external to the enterprise, to gain a holistic understanding of SME success dynamics.

This review adopts an integrative approach, drawing on institutional theory to elucidate the factors underpinning SME success and capability. Specifically, it examines the concepts of dynamic capability and adaptive capability, which are crucial for SMEs navigating the complexities of the contemporary business environment. Dynamic capability encompasses internal organisational attributes such as organisational capability, employee capability, and innovation, while adaptive capability pertains to the organisation's responsiveness to external market changes and environmental dynamics.

Key questions in this field revolve around how SMEs cultivate adaptive capability and leverage dynamic capability to achieve competitive advantages. By exploring the interplay between internal and external capabilities, this review aims to shed light on how SMEs can enhance their resilience, agility, and long-term viability in an increasingly turbulent business landscape.

In summary, this review aims to provide a comprehensive synthesis of the literature on SME success, culminating in a nuanced understanding of the multifaceted determinants and dimensions of success within the service sector and beyond. By elucidating the complex interplay between internal capabilities, external dynamics, and contextual factors, this review seeks to inform future research agendas and practical strategies to foster SME prosperity and sustainability.

2. SMEs and their uniqueness

2.1. Distinctive Characteristics of SMEs

According to Heilmann et al. (2020), SMEs are in a more advantageous position because of their flexible organisational structure and agile management practices. For example, SMEs can respond rapidly to the market since they can make quick decisions, and SMEs can implement specific strategies based on their resources and development requirements (Bartz and Winkler, 2015). SMEs often establish flat organisational structures that ease communication and encourage knowledge sharing. They respond quickly to customer feedback and establish close relationships with their customers (Clauss et al., 2022). Furthermore, the flat SME structure encourages innovation and the creation of effective and efficient working processes (Malodia et al., 2023; Randhawa et al., 2021). Employees are often given freedom and encouraged to actively enhance their skill set, which may attract potential customers due to the entrepreneurs’ open-minded growth orientation (van Gelderen et al., 2021).

Hashim and Wafa (2002) and Deros et al. (2006) claim SMEs have difficulty raising financial resources, lack access to commercial lending, lack management competencies and resources, and seldom offer employee training. Cash flow is difficult and may give rise to the inability to recruit highly skilled employees, and the employee turnover rate is high (Schwab et al., 2019).

Storey (1994) and Chicha and Julien (1998) argued a lot of the literature on small businesses offers characterisation for SMEs. These may be in terms of their diverse operational and management behaviour. Most of the characterisations, though, discuss only some basic facts about SMEs. In order to explore SMEs’ distinctive characteristics in a broad aspect, Nooteboom (1994) developed a profile to discuss SMEs’ identity using three core characteristics: small scale, personality, and independence. Peng and Meyer (2011) suggest...
small scale refers to the size of the business. Yet even though they are small, collectively, SMEs play an important role in contributing to the global economy. Bacon and Hoque (2005) argue that SMEs play a vital role in employment and GDP growth. SMEs account for two-thirds of jobs in Europe, and SMEs account for over 99% of total employment in the UK (European Commission, 2022). SMEs have provided over half the private workforce globally; they are still creating jobs (Federation of Small Business, 2016). Globally, SMEs account for over 95% of firms, and they contribute to 50% of the global economy; SMEs also supply 55% of all innovations.

Nooteboom (1994) argued that SME owners/managers have diverse personalities, which affects SMEs' business development. Previous research found personal characters and motivations within a firm determine its behaviour (Baron and Kreps, 1999; Bruining et al., 2005; De Kok and Ublaner, 2001; Wagar, 1998). The operation process in small firms is more flexible than that of large firms, and small firms tend to be more lax in applying rules. Moreover, due to SME owners' diverse business vision and their various capabilities, they are more agile in operation to achieve their business objectives. Given their size, SMEs can be more agile in establishing organisational structure, which enables them to achieve their business goals more effectively (Bartz and Winkler, 2015). Some authors argued SME owners tend to have more communication with their employees, so they can encourage knowledge sharing, and owners' leadership may encourage employees' commitment to their work (Baron and Kreps, 1999). Churchill and Lewis (1983) also clarify the relationship between the owners/founders and the SME, which is shown in Figure 1 below.

**Figure 1. Characteristics of Small Business at Each Stage of Development**

![Diagram of characteristics of small business at each stage of development](source)

Flexibility not only refers to organisational structure, Levy and Powell (1998) and Bartz and Winkler (2015) argue flexibility in managing SMEs' capability is an important feature. Flexibility can be divided into internal flexibility and external flexibility. Internal flexibility refers to a firm's ability to adapt to an organisation's internal environment, such as the firm's structure, its ability to meet employees' needs, personal contact with customers and the ability to improve employees' work-life balance (Ansoff, 1965). External flexibility refers to SMEs' ability to adapt to the changing environment. In terms of SMEs' small-scale features, personal
involvement and independence both determine the absence of bureaucracy in small firms. 
Levy et al. (2001) argue that these characteristics would increase the SMEs’ capability to respond quickly to the changeable market environment. Small scale, though, limits SMEs’ bargaining power in the market, but it can reduce some negative influences from the outside environment (Dickson et al., 2006). Small scale, personality and independence enable SMEs to focus on niche markets, developing their business based on their resources more flexibly.

2.2. SMEs Five Stage Development Model

SMEs cover a range of industries and at different development stages. Small businesses can be characterised by varied management styles, independence of operation process, differing corporate governance structures, varied management information systems, differing company sizes, flexible operation strategies etc. (Churchill and Lewis, 1983; Depaoli et al., 2020; Estensoro et al., 2022; Garengo and Bittici, 2007). Some research on SME success found small businesses apparently experience common operation difficulties and problems at similar stages of development (Simpson et al., 2012). Churchill and Lewis (1983) established a framework which consisted of 5 Stages, from survival to growth, see Figure 2.

**Figure 2. SMEs 5 Stages of Development**

![SMEs 5 Stages of Development](image)

Using the five stages of nomenclature of Churchill and Lewis's schema, this research has loosened the definitions and the interpretations as follows:

SMEs are considered to be in Stage I (existence), they are start-ups or young businesses less than three years old. They are looking for business opportunities or finding potential customers.
SMEs are at Stage II (survival), these firms are developing their businesses and generating customers but still hope to expand their business further.

SMEs at Stage III (success) have reached their break-even point and they are developing rapidly. Stage III (success growth) are continuing to develop and enhance their operations. Stage III (disengagement) appears to have developed as far as they desire.

Stage IV (take-off) is well-established and experiencing rapid growth. For some businesses at this stage are looking for the opportunity to sell their business.

Stage V (resource mature) is a relatively large size compared to the other SMEs and is well structured.

In the Stage I - Existence, the main challenge of SMEs is gaining sales and customers to achieve survival. For SMEs at this stage, the emphasis is on establishing better customer relationships and generating sufficient cash flow. Many researchers found SMEs at the start-up stage are often frustrated due to a lack of management capability and experienced employees (Xerri and Brunetto, 2011). SMEs are capable of launching new products and better service to the market, but they still find difficulty in searching for customers. Therefore, young SMEs often take a long time to build up their businesses. Given their small size, SME owners or managers are required to have management capabilities and strategies to tackle all aspects of business, manage daily business, get new customers, encourage employees and manage finance (Ernst et al., 2011; Walker and Brown, 2004). It has been found that small enterprises often have flexible organisational structures, can have more personal contact with customers, and are agile to market changes (Prakash and Gupta, 2008). However, many small businesses fail due to a lack of cash flow and business strategies and poor service quality (Walker and Brown, 2004). Only a few start-up small businesses can pass through the existence stage and maintain survival (Headd et al., 2010).

SME Stage II is survival. SMEs in Stage II have gained customers and have the financial resources to consider expansion. The major problem is still searching for customers and gaining more sales (Zumstein, 2007). It is argued that SMEs at Stage II focus on satisfying their current clients by offering more customer value to reach break-even. Some SMEs are lucky to have earned an economic return that allows them to grow. Managers and owners may lead a few more employees, but business owners and managers are still involved with most of the daily tasks, giving orders and decision-making. In terms of the organisational structure, it is a simple organisation with a flat structure with easy internal communication (Prakash and Gupta, 2008). The main tasks for SMEs at this stage are maintaining their survival and expanding their sales. Owners and managers represent the business, and such leadership plays a vital role in business performance and success. Once SMEs reach their break even or generate more cash flow, they are likely to expand and move on to the next stage. Small businesses at this stage can fail due to lack of cash flow, which will mean they struggle to remain in the 'survival' stage and return to the 'existence' stage.

At Stage III, SMEs become quite successful and they can maintain a profitable status quo. They establish a basic organisational structure, and the main aim is to maintain company stability and profitability. The owner uses the current company as a platform to grow their business, or they can set up spin-off businesses. In fact, SMEs at the success stage can be sold or acquired by large firms. However, most SMEs may still want to consolidate the company or develop further, generating more wealth and looking for opportunities to expand to
broader markets (Dominguez and Mayrhofer, 2017; Tolstoy et al., 2021). SME owners may become less involved with daily management, delegating management roles to others, such as hiring managers or CEOs (Rozyn, 2010). Owners take a more strategic role with goals, perhaps of achieving business growth. If, unfortunately, SMEs cannot generate enough wealth to maintain their success, they still face difficulties in survival or may even become bankrupt. It may take a long time for SMEs to generate sufficient cash flow and become really successful, especial under disruptive events such as Covid-19 (Belghitar et al., 2022; Calabrese et al., 2022). When SMEs establish mature systems with formal structures, they start to move towards Stage IV Take-off.

At Stage IV, Take-off SMEs have divisional organisations and put more emphasis on growing their business and generating wealth. One of the concerns is that SMEs may have developed too fast, so the owner may lack the appropriate skills to manage a business. In most cases, owners or people who bring business from the success stage to the take-off stage cannot delegate since there is an issue over control (Nag et al., 2020). Some SME owners delegate their responsibilities by hiring CEOs or managers with the required skills. Family-controlled businesses may not follow such a path. An increasing separation between the owner and business may develop. Some owners will sell their business. If a take-off company fails to transfer from the success stage to take-off, then the company will remain in the success stage. This may be acceptable to the owners and is regarded as disengagement. CEOs or managers who cannot lead their business development or cannot handle the development may run into barriers such as uneven economic conditions and unpredictable changes, and hence the company could drop back to the survival stage or even bankruptcy (Fischer and Reuber, 2003; Josefy et al., 2017; Lee et al., 2020).

When SMEs reach Stage V resource maturity, they usually have a very formal organisational structure and extensive operational systems, but may continue to face some development problems. SMEs may focus on consolidating and maintaining their financial gains (Campa, 2015). Some authors suggest SMEs retain their advantages by being small, maintaining a flat organisational structure and being agile businesses (Gherhes et al., 2016). Unexpected issues may exist that act as a barrier to expansion. SMEs were found to take advantage of budget plans, strategic planning, standard cost control systems to eliminate the inefficiencies during operation (Churchill and Lewis, 1983; Peng, 2001). SMEs’ management style can be more decentralised and their business systems are extensive at the resource maturity stage, owners focus has moved more to investment decisions. CEOs or managers take full responsibility for deploying well-defined business strategies for further development (Colovic, 2022; Garavan et al., 2016; L. Li et al., 2018; Vanninen et al., 2022).

3. SMEs and success

3.1. Definition of Success

Historically, business success has tended to be viewed in terms of financial success, yet it is widely accepted that this is only one of many elements. This is especially true for SMEs in how they view success. Some authors argue firms should also consider a wide range of measures in assessing their success (Bauer et al., 2018; Del Giudice et al., 2021; Zhu et al., 2023). A common theme is the growth of the business as a measure of success. The form of growth becomes an issue, though, whether it is increasing the number of customers or expanding the geographic region (Gherhes et al., 2016; Miocevic and Morgan, 2018).
Sometimes it is interpreted as market share, sustained business expansion or even becoming more widely recognised (Altinay et al., 2016; Miocevic and Morgan, 2018). Yet one has to remember that these are labels established by external people and not the attitude of SME owners. It is argued later that there is a need to understand SMEs' goals to assess their performance and sustainability, and this will be determined by the goals and ambitions of the owners/managers.

The motivations behind the setting up of a business vary and these greatly affect how businesses assess SMEs success. New SMEs are primarily concerned with the struggle for survival and so focus on funding, with cash flow being a major concern (Walker and Brown, 2004). Birley and Westhead (1994) argued that motives, skills and ambition will influence the direction of an SME business. The business owners’ sense of achievement, enjoyment, job satisfaction and even continued survival will play a role (Weaven et al., 2021). Past research has often focussed on a single measure and not the multi-dimensional scales that seem more appropriate (Simpson et al., 2012). A richer description is required as solely using financial measures cannot capture the complexity of small businesses in different sectors (Gaies et al., 2023; Stam and Van de Ven, 2021). It is soon obvious that SME owners do not run their businesses only to achieve financial benefit; they run their businesses for other reasons, such as lifestyle, work-life balance (Leung et al., 2020), social impact or social responsibility or to operate a decent business model (Stoian and Gilman, 2017). The concept of lifestyle SMEs and high growth SMEs are two terms that fundamentally show the external visions of SMEs. Lifestyle is seen perhaps in a negative light, assuming a retreat from economic contribution, whereas high growth is seen as a champion of the new economic high ground. Others will be take professional pride and status considerations into account. This was highlighted by Simpson et al. (2012).

Success for an SME is seen as closely linked to SMEs' performance and is mostly described by financial status or economic survival. Yet, non-financial business goals will lead to alternative measures for defining business success, especially in small businesses. Most SMEs describe their success in financial terms or business growth. Especially new start-up SMEs that are struggling for survival consider financial criteria the most appropriate measures of business success (Sardo et al., 2018). Some authors argue that firms should also consider their sales growth, market share, the firm's goals, objectives and other broad elements in assessing their success, not just focus on financial measures, since not all SMEs are established to achieve financial goals, and many start-up businesses are set up on the basis of the personal goals of the owner(s) which may be non-financial (Ng and Kee, 2018; Nikolić et al., 2018). These non-financial goals are increasingly taken as defining SMEs success. El Shoubaki et al. (2020) and Eide et al. (2021) argue that the motives, skills and ambition will influence SMEs business.

There is a growing view that the definitions of business success rely on business owners' personal goals and business objectives instead of financial goals. It will comprise business owners' sense of achievement, enjoyment, job satisfaction and even continued survival (Staniewski and Awruk, 2019). Simpson et al. (2012), however, argued that most previous research on SME success often relies on a single one-dimensional measure, such as business growth, increased employee numbers, earning more benefits, more customers, etc., but not multi-dimensional measures. Some researchers suggest both operational performance indicators and financial performance could achieve a richer description of the SMEs.
Proposing a Conceptual Framework for the Study of SME Success in Service Industry

(Centobelli et al., 2019). Solely using financial indicators in measuring business performance success is not able to capture the complexity of objectives for small businesses in different sectors. Frecknall Hughes et al. (2007) claim single measures such as return on investment (ROI), return on capital employed (ROCE) are very poor measures but they are still used by some firms. Therefore, SMEs’ success should be assessed through a combination of various financial measures and non-financial achievements that are most appropriate. Performance is regarded as one measure of success, and it serves SMEs with multiple objectives in different development stages. This research classifies SMEs' measures of success into financial performance and non-financial performance. Table 1 presents the main elements for measuring SMEs’ performance.

Table 1. SMEs performance categories

<table>
<thead>
<tr>
<th>Measure of Success</th>
<th>Financial indicators</th>
<th>Non-financial indicators</th>
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<tbody>
<tr>
<td></td>
<td>✓ Revenue</td>
<td>✓ Customer Value Performance (market share, customer satisfaction measures, customer loyalty);</td>
</tr>
<tr>
<td></td>
<td>✓ Income Statement</td>
<td>✓ Internal Business Process performance (productivity rates, quality measures, timeliness);</td>
</tr>
<tr>
<td></td>
<td>(Profit)</td>
<td>✓ Innovation Performance (percent of revenue from new products, employee suggestions, rate of improvement index);</td>
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<tr>
<td></td>
<td>✓ Debt</td>
<td>✓ Employee Performance (morale, knowledge, turnover, use of best demonstrated practices).</td>
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<tr>
<td></td>
<td>✓ Financial Ratio</td>
<td></td>
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<tr>
<td></td>
<td>(Return on investment or capital)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>✓ Cash flow</td>
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<td></td>
<td>✓ Balance Sheet</td>
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<tr>
<td></td>
<td>(Statement of financial position)</td>
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Source: Author

A number of researchers, such as Wood (2006), Lexutt (2020), and Gaias et al. (2023) suggest it is necessary to measure a firm’s performance as a success measure by measuring both its financial and non-financial perspectives. A firm’s financial performance and non-financial performance vary according to the firm’s operation process and development stage. Therefore, this research explores SMEs goals and success through measuring their performance at the different stages of development.

3.2. Success Models in SMEs

The literature acknowledges the diverse view of success within SMEs, accepting the major determinants as the owners' goals and other non-financial performance. Growth seems to underpin many of the attitudes towards success, but this is not solely in terms of finance and includes opening up new markets and views of SME owners’ personal goals (Döckel and Ligthelm, 2015). It is also clear that the factors for success include the quality of employees, maintaining customer satisfaction and having broad supportive networks. This research seeks to explore in more depth the views of SMEs of success and establish the factors that affect it. Hence, it explores the issues raised in the literature to confirm or refute assertions made.

Due to the diversity of SMEs and the definitions vary from country to country, there is no fixed definition for success, success is often regarded as achieving company goals with better performance (Aguilera et al., 2024; Zaefarian et al., 2017). Profitability is no longer the only indicator for considering business success, recently researchers discover business owners or managers focus more on non-financial lifestyle criteria (Walker and Brown, 2004). The traditional approach regarding performance measurement and defining critical success factors
within SMEs is normally described as an “experimental black box” approach, and Short et al. (2002) called it the “the normal science mode.” Traditional approaches to collecting SMEs’ performance data rely much on questionnaire surveys using Likert scales or cross-sectional methods (Tan and Peng, 2003; Widener, 2006) to estimate SMEs’ past performance. It is well-known that SMEs do not systematically collect and analyse their operational data, so it increases the difficulty of collecting the data accurately and precisely. In this circumstance, it becomes more difficult to meet the SMEs’ current business objectives due to the dynamic business environment and diverse trading conditions (Hamilton and Webster, 2015). Therefore, it is difficult to measure the SMEs’ operating environment and define SMEs’ critical success factors. This demonstrates the traditional approach to measuring SMEs’ performance and their success factors can no longer have practical use.

Simpson et al. (2012) propose using a holistic theoretical framework that comprises the business environment, the enterprise, factors critical for success, definition of success, measures of performance and feedback. These six elements comprise the critical success factors and performance within SMEs. In their research, a literature review, in-depth interviews with 20 SMEs owners/managers, and a knowledge elicitation exercise are used to facilitate the analysis of their proposed framework. They reviewed the literature to discuss and analyse the six elements of the framework with the support of interview results. They have concluded there is no fixed consensus towards SMEs’ success or performance that needs to be measured or how success factors contribute to SMEs' performance. But SMEs are encouraged to improve their performance through emphasis on identifying critical success factors (CSFs), establishing performance measurement systems, reviewing feedback, improving their current techniques or knowledge and modifying their strategies. However, their research did not explore performance and success according to SME goals and stages of development. This research seeks to contribute to understanding SME success and performance by taking a more nuanced view that accounts for the stage of development and SME goals.

Referring to their theoretical framework, explores both the enterprise's internal elements and the business environment's outside factors (Simpson et al., 2012). Their research work reviews SMEs success with an emphasis on the effect of performance feedback on the SME owners/managers. They argued that traditional research depends on the views, opinions, and perceptions of owners/managers, but a longitudinal multi-dimensional approach needs to be adopted in future research. They developed a new model that critically evaluates firms’ success and confirms that financial performance and business growth are necessary for SMEs, especially for SMEs who are struggling to survive. However, not all SMEs are established only for achieving financial achievement and many start-up businesses are established based on lifestyle or personal goals and these non-financial goals are increasingly used to define SMEs' success (Gaies et al., 2023; Lexutt, 2020). This new framework suggests the use of sales growth, market share, the firm's goals, objectives and other broad elements in assessing their success, but the focus should not be on a single measure.

Since using financial indicators in measuring business performance success is not able to capture the complex objectives of small businesses from different sectors (Jarvis et al., 2000). Based on this new model, Simpson et al. (2012) argue that most previous research on SMEs' success often relies on a single one-dimensional measure, such as business growth, increased employee numbers, earning more benefits, more customers, etc., and cannot assess SMEs'
success and performance appropriately any more, multi-dimensional measures are needed. This new CSF framework explored SME success based on more practical views; it emphasises that defining business success relies on business Owners' personal goals and business objectives instead of financial goals that comprise business Owners' sense of achievement, enjoyment, job satisfaction and even continued survival (Greenbank, 2001; Walker and Brown, 2004).

3.3. Growing importance of non-financial success elements

3.3.1. Employee Capability

Performance of a business is geared to its workforce (Brauer and Zimmermann, 2019; Fehr et al., 2017; Luciano et al., 2020; Schneider et al., 2018). Malik et al. (2022) and Fehr et al. (2017), Li (2023) and indicates that employees' behaviour and employee performance can bring significant competitive advantage to an SME, especially in this circular economy. Employee performance has been widely used as an indicator to measure a firm's overall performance (Bain&Company Guide, 2013). This is also true for SMEs. Given the nature of SMEs, they have expectations of employees in terms of commitment of time and effort. Yet it can lead to conflicts for employees over work-family balance. Therefore, it is critical to manage employees appropriately to achieve the goals of an SME. Employee performance has been widely used as an effective indicator to measure a firm's overall performance that is based on their morale, knowledge, working capability, employee turnover rate, teamwork, knowledge sharing, employees' suggestions, working attitude, learning capability and personal relationships with clients can all determine SMEs business development (Bain&Company Guide, 2013; Pillemer and Rothbard, 2018).

Previously published articles indicate there is a close link between human resources and a firm's performance, especially in the digital economy or sharing economy (Chadwick, 2017; Li, 2019; Malik et al., 2022). Such practices cover employee selection, incentive pay, job design and task analysis, knowledge and information sharing, employee performance appraisal, teamwork, employee training and development and internal promotion. Regarding SME's nature, size and flexibility, it is more likely that capable employees will be empowered to recognise a problem and create appropriate solutions (Ho and Kuvaas, 2020; Schneider et al., 2018).

Parker et al. (2017) and Gahan et al. (2021) conclude high involvement or high performance requires employees with relatively high working skills and well-designed working conditions. Such conditions enable employees to have more discretion and opportunities to participate in collaborating with others. A good incentive structure and a welcoming working culture can enhance employees' motivation, retention, and commitment. Investing in employee training not only enhances employees’ capability and so firms' productivity, performance and profitability, but some authors argue it also increases the likelihood of retaining the employees (Riley et al., 2017; Sung and Choi, 2023). It also can enhance small firms' survival rates, and it is found that successful SMEs provide more employee training than less successful ones. However, small firms have limited resources and capital, and business owners are more likely to have a negative attitude towards employee training, especially in the chase for short-term profitability; as such, they prefer to recruit more skilled employees rather than invest in training.
The nature of work and the changing workforce have put pressure on employees, which affects their performance and the organisation’s performance (Pillemer and Rothbard, 2018). For fast-growing SMEs, employees may find problems in resolving work-life balance due to the stressful environment, which could lead to a negative impact on employees’ motivation and so affect SMEs’ businesses (Netemeyer et al., 2005). Loss of individual employees may be more damaging to SMEs than large companies; employee performance appraisal should be applied in the human resource management decision-making process as one indicator. Since every SME has its own operation system and their working environment varies, there is no fixed performance appraisal method that all SMEs can use. It is always challenging for SMEs to manage their employees.

3.3.2. Customer Relationship Building

According to Bain & Company (2005), customer relationship management (CRM) ranked as the second most important management tool used by both larger enterprises (LES) and small and medium-sized enterprises (SMEs) to develop their business (Guerola-Navarro et al., 2021; Varadarajan, 2020). The following figures compare the most widely use strategies by firms and CRM accounts for a rate of 70% for small firms and 72% for medium firms. There is sufficient evidence that a close relationship between customer satisfaction and a company’s non-financial performance (Hallikainen et al., 2020; Li, 2019). The fundamental assumption is that higher customer satisfaction will lead to higher customer retention, which can enhance a firm’s financial performance. Previous research explores the cost to achieve customer satisfaction, such as positive advertising cost, enhanced firm reputation cost, brand awareness establishment cost, and the profit that can be achieved through this process and the growth number of customers as well (Huang et al., 2019; Ittner and Larcker, 2003). In terms of firm-level research, they find higher customer satisfaction could lead to firms’ accounting book values and enhance their market reputation. They also investigated how SMEs establish customer relationships for business development at diverse stages.

Research has been carried out on CRM, and most regard CRM as a set of management processes or actions that can be used to improve customer experience and help companies achieve their desired business outcomes (Witell et al., 2020). CRM is regarded as a functional tool for companies to achieve competitive advantage that can be used to gain long-term benefits (Fan and Ku, 2010; Plakoyiannaki et al., 2008; Reimann et al., 2010). Some researchers regard CRM as a cross-functional process or organisational strategy that not only manages customer interactions but also identifies the most valuable customers and provides customised service based on their various requirements to achieve long-term, profitable relationships with their customers (Porter, 2011).

Customers/clients are the mainstay of all businesses, so SMEs should try to establish appropriate customer relationships to achieve customer satisfaction. Some argue that better understanding a customer allows businesses to identify the most valuable customers and provide customised service based on their various requirements to achieve long-term profitable relationships with their customers (Porter, 2011). Futterer et al. (2018) discovered that customer satisfaction is a major factor affecting both SMEs' non-financial and financial performance. Similarly, a series of authors (Davenport and Beers, 1995; Ernst et al., 2011; Hammer, 1996) regard better CRM as one functional tool to measure their business performance to achieve a business’s objectives more effectively.
Customer performance measurement acts as one functional tool to measure SMEs' business performance. All SMEs involved in this research claimed they regard customer satisfaction as an important indicator to measure their business performance. Customer satisfaction can be achieved through providing higher customer value from a business' products or services. 

Simpson et al. (2001) propose that customer value must be inclusive of all the benefits a firm provides directly and indirectly. Some researchers regard customer value as the value creation process from a customer perspective that firms provide to customers, such as entire products, services, personnel, post-service, and image values (Armstrong et al., 2012). However, SMEs still face great challenges in acquiring and retaining customers. Sometimes, the focus on survival means SMEs pay less attention to short-term sales rather than developing longer-term relationships with customers (Li, 2019).

### 3.3.3. Customer Satisfaction

Han et al. (2019) suggest that customer satisfaction can be discussed from both the consumers' and companies' perspectives. In terms of the consumer's perspective, customer satisfaction can be considered as the customer's attitude toward how the company fulfils their needs and requirements. SMEs, especially at an early stage of development, may care more about individual client's needs and requirements and try to satisfy every individual client (Lundahl et al., 2009). In terms of the company's point of view, customer satisfaction refers to a firm's capacity to satisfy consumers' needs and requirements economically, emotionally and psychologically. SMEs were found to have a more personal touch with their clients, which enabled them to establish better relationships with individual clients compared with large firms (Casidy and Nyadzayo, 2019; McDougall and Levesque, 2000).

Spreng and Mackoy (1996) were regarded as the first authors to regard consumer satisfaction in terms of a consumer’s fulfilment response, and they further demonstrate that customer satisfaction is influenced by consumers' expectation that includes both positive and negative affective responses as well as cognitive disconfirmation. Customer satisfaction has been identified as a critical factor in the formation of consumers' purchase intentions, and it is regarded as a critical issue in the success of any business system due to customer satisfaction could significantly affect customers' attitude and their intention to purchase. Zeithaml et al. (2006) emphasise the importance of customer satisfaction and argue that most research in service marketing has relied exclusively on customer satisfaction. Ernst et al. (1991) found that customer satisfaction measures accounted for 54% of primary importance for strategic planning in surveyed organisations in 1988 and, dominate 80% of importance in 1991, and were expected to be 96% of importance in 1994. Anderson et al. (1994) and (Graf et al., 2013) found higher customer satisfaction can be achieved through activities such as increasing customers' loyalty, reducing price elasticity, lowering marketing costs by positive word-of-mouth advertising, reducing transaction costs and enhancing firm reputation. They further investigated 77 Swedish firms and demonstrated customer satisfaction is positively associated with accounting returns. Yang and Peterson (2004) find higher customer satisfaction could lead to greater customer loyalty, and so can be turned into future revenue (Bolton, 1998; Ittner and Larcker, 2003). Based on the empirical research and the results provide significant evidence that customer satisfaction positively affect firms' financial performance, using customer and business-unit data, Ittner and Larcker (1998, p. 32) demonstrated “customer satisfaction measures are leading indicators of customer purchase behaviour such as retention, revenue
and revenue growth, growth number of customers, and firms' financial performance which includes business-unit revenues, profit margins and return on sales as well”.

Edeling and Himme (2018) also investigated customer satisfaction and confirmed that a good relationship with customers enhances SMEs’ market share and financial performance. Based on the study of Ho and Wu (1999), they propose five antecedents that would influence customer satisfaction which include logistical support, technological characteristics, information characteristics, homepage presentation and product characteristics. They further explored the five antecedents that are significantly correlated with customer satisfaction among cyber industries. Customer satisfaction can be achieved through providing higher customer value from a business's products or services. Nasution et al. (2011) and Kumar (2018) propose that customer value must be inclusive of all the benefits a firm provides directly and indirectly.

3.3.4. Innovation

Clauss et al. (2022) argued that innovation is a firm's competency to receive and adapt new ideas to improve their current business situation and make developments, especially during disruptive events such as Covid-19. Innovation should be an improving process that brings new technology or concepts for companies to modify their current working procedure and improve their customers’ satisfaction (Chan et al., 2019; Huggins and Johnston, 2009).

Service industries contribute a significant part to global major economics; innovation is regarded as the driving force of growth in most firms (Agarwal et al., 2003). There are difficulties in differentiating services industries and manufacturers; there is needed to understand the underlying relationship between developing service innovation and SME performance. There has been an emerging research area on service innovation development (Jaw et al., 2010). Small firms should be innovative to compete with larger ones, especially to distinguish their products or services from their competitors.

Terziovski (2010) has researched around 600 SMEs, and based on their findings, it is suggested that SMEs are better at implementing innovation strategies, designing formal innovation structures, creating an innovation culture, remaining innovative in establishing customer and supplier relationships and developing technological capabilities. The development of those innovative processes significantly affects SMEs' performance positively. Prakash and Gupta (2008) found there is a positive and significant relationship between establishing formalised innovation culture and improving SMEs performance. Terziovski (2010) argued that not only large enterprises focus on their innovation management, but SMEs also need innovation strategies to enhance performance. Many scholars have debated that SMEs need to formalise their innovation culture and systems in order to become more competitive and improve their performance (Albiats et al., 2023; Latifi et al., 2021; Malagueño et al., 2018). Innovation is widely regarded as process improvement, especially in the service industry and manufacturing sectors, by squeezing costs out (Lim and Fujimoto, 2019). The previous literature generally agrees that firms with formal innovation strategies will perform better compared with those without implementing innovation strategies (J. Li et al., 2018).

Barney (1991) proposed firms should concentrate on using a resource-based view to develop their competitive advantage. Terziovski (2010) suggests SMEs could also reform their
innovation culture and system based on the resource-based view to achieve higher performance. It is argued that SMEs should develop their competitive advantage through their employees’ innovative potential to develop differentiated products to fill their niche market (Knight et al., 2020). Employees need to be engaged in the innovation development process such as in technical aspects, design, marketing new products or service and resource use (Marion and Fixson, 2021).

4. SME, dynamic capability and performance

Teece et al. (1997, p. 516) define dynamic capabilities as “the firm’s ability to integrate, build, and reconfigure internal and external competencies to address rapidly changing environments”. The competitive advantage of a firm is seen as resting on distinctive processes shaped by a firm’s specific asset positions and the evolution paths it has adopted or inherited. Consequently, some researchers argue that dynamic capability or a firm’s ability to integrate, build and reconfigure resources is needed to improve a firm’s competitive advantage in a volatile market environment (Li, 2019; Newbert, 2005; Teece, 2007; Zollo and Winter, 2002). The competitive advantage can be eroded depending on the stability of market demand, the ease of replicability and imitability. Hence, dynamic capability plays a function that supports firms in creating wealth in regimes of a rapidly changing technological environment that hones internal technological, organisational, and managerial processes within a firm. A firm's dynamic capabilities help it to identify new opportunities, ensuring organisational effectiveness and efficiency to keep competitors off balance, raise rivals' costs and exclude new entrants.

After Teece et al. (1997) raised the concept of the dynamic capabilities view, it attracted increasing attention within the management literature due to its function to develop a firm's competitive advantage. Based on the ABI database, there were at least 1,534 articles which used the dynamic capability concept between 1997 to 2007 across different subjects (Barreto, 2010). The current economic context seems to present more risks and challenges because of the hypercompetitive environment, which tends to be associated with the increasingly frequent occurrence of major, discrete environment shifts in competitive, technological, social, and regulatory domains (D’Aveni and Gunther, 2007; Veliyath, 1996). Knudsen et al. (2021) discovered that the average period for firms to sustain their competitive advantage has decreased over time, and firms in hypercompetitive environments will find it harder to achieve long-term sustainability. It was found that dynamic capabilities are the main resources of competitive advantage for firms that can rapidly integrate, learn, and reconfigure their internal and external resources to adapt to rapid environmental changes and, thus, enhance and maintain their competitive advantages (Mikalef et al., 2019; Suddaby et al., 2020; Warner and Wäger, 2019). Audia et al. (2000) and Teece (2007) claim that failure to address some major market environment changes can lead to negative effects on a firm’s competitive advantage to improve its performance. Teece’s definition of dynamic capability built on several main elements to highlight its theoretical underpinnings, such as nature, role, context, creation and development, outcome and heterogeneity; many scholars have defined their understanding of dynamic capability, and the main definitions of dynamic capabilities are shown as follows Table 2.
**Table 1. Key Definitions of Dynamic Capabilities**

<table>
<thead>
<tr>
<th>Source: Developed by Current Author Research Study</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Teece and Pisano (1997, p.541)</td>
<td>The subset of the competencies and capabilities that allow the firm to create new products and processes and respond to changing market circumstances</td>
</tr>
<tr>
<td>Teece et al. (1997, p. 516)</td>
<td>The firm’s ability to integrate, build, and reconfigure internal and external competencies to address rapidly changing environments</td>
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<tr>
<td>Eisenhardt and Martin (2000, p. 1107)</td>
<td>The firm’s processes that use resources—specifically the processes to integrate, reconfigure, gain, and release resources—to match and even create market change; dynamic capabilities thus are the organisational and strategic routines by which firms achieve new resource configurations as markets emerge, collide, split, evolve, and die</td>
</tr>
<tr>
<td>Teece (2000, p. 35)</td>
<td>The ability to sense and then seize opportunities quickly and proficiently</td>
</tr>
<tr>
<td>Zollo and Winter (2002, p. 340)</td>
<td>A dynamic capability is a learned and stable pattern of collective activity through which the organisation systematically generates and modifies its operating routines in pursuit of improved effectiveness</td>
</tr>
<tr>
<td>Winter (2003, p. 991)</td>
<td>Those (capabilities) that operate to extend, modify, or create ordinary capabilities</td>
</tr>
<tr>
<td>Zahra et al. (2006, p. 918)</td>
<td>The ability to reconfigure a firm’s resources and routines in the manner envisioned and deemed appropriate by its principal decision-maker(s)</td>
</tr>
<tr>
<td>Helfat et al. (2007, p. 79)</td>
<td>The capacity of an organisation to purposefully create, extend, or modify its resource base</td>
</tr>
<tr>
<td>Teece (2007, p. 1319)</td>
<td>Dynamic capabilities can be disaggregated into the capacity (a) to sense and shape opportunities and threats, (b) to seize opportunities, and (c) to maintain competitiveness through enhancing, combining, protecting, and, when necessary, reconfiguring the business enterprise’s intangible and tangible assets</td>
</tr>
<tr>
<td>Barreto (2010, p. 271)</td>
<td>A dynamic capability is the firm’s potential to systematically solve problems, formed by its propensity to sense opportunities and threats, to make timely and market-oriented decisions, and to change its resource base.</td>
</tr>
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</table>

Based on several definitions of dynamic capabilities, dynamic capability can be seen as a kind of capacity, process or routine that facilitates enterprise business management processes. **Teece and Pisano (1994)** emphasise that enterprises should strengthen their fundamental capability to meet customer needs and requirements. **Eisenhardt and Martin (2000)**, **Zollo and Winter (2002)** and **Winter (2003)** highlight enterprises should be more agile toward the market change due to the market dynamics. This refers to the current hypercompetitive environment enterprises face nowadays. Therefore, enterprises should continue growing and developing their stage of development to be more adaptive in the changing environment. This implies enterprises should be more adaptive to relying on existing knowledge and also situation-specific new knowledge. Using capacity instead of capability highlights the dynamic capability, which is the ability to perform a task in at least a minimally acceptable manner (**Helfat et al., 2007**). What is more, **Zahra et al. (2006)** and **Teece (2007)** propose that dynamic capability should reconfigure, enhance, combine, protect, modify and extend the enterprises’ both intangible and tangible resources based on the nature of the enterprises. That means the
enterprises should have their embedded characteristics based on their own organisational structure and also the stage of development based on their dynamic organisational capability, which is fundamental for SME business.

Based on Teece et al.’s (2007) dynamic capability view, dynamic capabilities enable firms to renew their competencies to meet the hypercompetitive market, to develop firms' capabilities that include the ability to integrate, learn, and reconfigure both internal and external organisational skills and resources, to sense the market opportunities, to seize the opportunities, and also to maintain competitive advantages through enhancing the firm's intangible and tangible resources (Wu, 2010). Some authors argue that dynamic capability is essential to identify a firm's competitive advantage, especially under environmental volatility (Eisenhardt and Martin, 2000; Newbert, 2005; Zollo and Winter, 2002). Wu (2010), in the research on the applicability of resource and dynamic capability views under environmental volatility, demonstrated that a firm facing a low or medium volatility environment can gain competitive advantages through resources, particularly when they emphasise Valuable, Rare, Inimitable, Nonsubstitutable (VRIN) resource accumulation. However, in highly volatile environments, the effects of resource accumulation on gaining competitive advantages are considerably reduced, which means in high volatility environments firms cannot rely on previously accumulated business resources to gain competitive advantage.

Teece (2007) argued that dynamic capabilities enable business enterprises to create, deploy, and protect the intangible assets that can support their superior long-term business sustainability in an open economy. Those enterprises can have rapid innovation and globally dispersed sources of invention, innovation, and manufacturing capability. The micro-foundations of dynamics, such as the distinct skills, processes, procedures, organisational structure, decision rules and disciplines, can underpin firms’ sensing, seizing and reconfiguring capabilities. Some authors argue enterprises with strong dynamic capabilities are intensely entrepreneurial in that they can not only adapt to the business ecosystems but also share them through innovation and collaboration with other firms or organisations to strengthen their organisational capabilities (Arend, 2014; Teece, 2007). The long-term success depends on the external business environment. The enterprise’s own internal dynamic capabilities lie at the core of enterprise sustainability and success.

Given the market, environment exposes SMEs to both opportunities and threats from rapid technology, enterprises' success cannot be sustained on simple approaches such as economies of scale. They need a holistic approach with dynamic and organisational abilities that will ensure they are responsive to their environment, discover new opportunities with innovation in technologies, and ensure new business models can be generated with the protection of intellectual property rights. Several authors have contributed to these themes (Rajwani and Liedong, 2015; Sousa and Aspinwall, 2010; Teece, 2007; Terziovski, 2010).

The traditional elements of business success, such as maintaining incentive alignment, owning tangible assets, controlling costs, maintaining quality, and optimising inventories thought necessary in the current business context, are unlikely to be sufficient for enterprises to maintain superior performance. Recognising new challenges in today's hypercompetitive environment and understanding the development of technological innovation are needed. Therefore, it is argued that innovation is not only about new products; it is reinventing business processes and building entirely new markets that meet untapped customer demand through building and integrating enterprises' both internal and external competencies (Teece,
Dynamic capabilities assist in achieving technical fitness and evolutionary fitness in the diverse and open global economy.

The development of enterprises' intangible resources and intellectual capital is increasingly recognised as central to sustained enterprises' competitiveness and sustainability (Evans et al., 2008). The ability to access existing and new information and knowledge can create market opportunities. In order to identify and share market opportunities, enterprises have to constantly scan, search and explore both local and distant markets. Dynamic capabilities enable enterprises to understand latent demand, the structural evolution of industries and market, suppliers and competitors' reaction to the market etc. (Teece, 2007). The implication of dynamic capabilities enables enterprises to interpret new opportunities and figure out which technology to pursue and which market segments to target.

Within the dynamic capabilities concept, the environment context it recognised for analytical purposes is not only for industry, but for the entire business ecosystem, such as the community of organisations, institutions, external business environment, suppliers, customers, collaborators etc. (Teece, 2007). It also can sense opportunities and threats that facilitate enterprises to employ the most appropriate practices and strategic management to develop their businesses. A new framework is developed to sense market and technological opportunities for enterprises as follows.

**Figure** Error! No text of specified style in document. Elements of an ecosystem framework for sensing market and technological opportunities

![Diagram](journals.tplondon.com/tbm)

Figure 3 above illustrates enterprises can sense market opportunities through four different aspects such as internal research and development based on new technologies, new suppliers and complementary innovation, development of exogenous science and technology and target market segments based on customers' needs and requirements. Helfat et al. (2007, p. 79)
defined dynamic capability as “the capacity of an organisation to purposefully create, extend and modify its resource base” which includes tangible, intangible and human resources the enterprise owns or controls. One significant contribution of dynamic capabilities is to understand how firms can sustain a competitive advantage by responding to environmental change and ecosystem (Helfat and Peteraf, 2009; Teece, 2007). The enterprises need to sense, seize and transform their capabilities to be simultaneously developed and applied to maintain competitive advantages. Figure 4 below demonstrates the relationship between dynamic capabilities and business performance.

**Figure 4.** Foundations of dynamic capabilities and businesses performance

Based on the findings from the above framework, it regards dynamic capability as the foundation of enterprises' competitive advantages in regimes of rapid technological change, especially in the current hyper-competitive environment. However, the extent to which enterprises can develop and employ dynamic capabilities is determined by the nature of enterprises the intangible resources they have and their financial situation. Therefore, the enterprise's past performance and organisational capability will impact current and future enterprise performance. **Teece (2007)** argued that the core elements of dynamic capability, such as integrating, learning and reconfiguring, are subset processes that support sensing, seizing and managing threats. Since the most valuable assets within an enterprise are knowledge-related and non-tradable, this enables the enterprise to have a competitive advantage to sense and seize opportunities based on its organisational capabilities. An enterprise can shape its ecosystem relying on its organisational capability and past performance; in fact, the enterprise and its environment frequently coevolve.

The dynamic capability framework enables enterprises to capture the key variables and competencies that need to be manipulated to create, protect and leverage their intangible resources through which it can achieve superior performance and avoid the zero profit trap (Teece, 2007). Enterprises are encouraged to sense, seize and transform based on the nature of their businesses. The application of dynamic capability enables enterprises to select suitable business models, make the right strategic decisions and pursue incremental innovation that
can keep the enterprises highly competitive and achieve better performance (Ettlie and Pavlou, 2006; Teece, 2007), as confirmed by the empirical findings in the UK SMEs (Li, 2019).

5. Concluding remarks

This research aims to shed light on a better understanding of SMEs' success and how they achieve their success. This paper reviewed relevant literature to underpin the understanding of SMEs' success and the sources they use to achieve competitive advantages. Previous literature on SMEs in the UK has relied on defining SMEs in terms of employee size (less than 250) and turnover (less than € 50 m). Globally, though, there is no fixed definition for SMEs. Most firms, such as the start-ups and young firms in this research, confirmed they regard themselves as SMEs because they have limited numbers of employees and clients. A few well-established businesses, however, still regard themselves as small firms even if they have a large number of employees, say around 200, because their competitors are much larger. Surprisingly, a few firms, which have around 20 employees, classify themselves as medium firms, due to their outstanding business achievement within their specific market and their market size (Li, 2019). Previous literature on SMEs' success is seen as closely linked to SMEs' performance, which includes both financial measures and non-financial measures (Jennings and Beaver, 1997). Yet it does not necessarily cover the general environment, internal and external of business, which may also characterise success in terms of the SMEs' view. So, rather than predefining success, the views of SMEs should be sought.

In summary, this appraisal has examined existing research on small and medium-sized Enterprises (SMEs), particularly focusing on definitions, measures of success, characteristics, stages of development, and assessment criteria. It has been observed that there is no universally standardised definition of SMEs due to the diverse nature of their businesses and developmental stages, although employee size is commonly used as a defining factor across countries.

Past studies predominantly employ single measures to evaluate SME success, often overlooking SMEs' own perspectives on success according to their goals and stage of development. Therefore, this research aims to explore SMEs' perceptions of success from various angles, considering factors impacting their success as perceived by SMEs themselves. This warrants further studies and fine-tuning of our thinking and scholarship on the matter.

The literature has identified several dimensions of SME characteristics potentially contributing to success, including elements such as business ecology and capabilities. Thus, the investigation delves into dynamic business environments to elucidate strategic advantages for SMEs, such as flat organisational structures, effective communication, knowledge sharing, and employee engagement.

Furthermore, Churchill and Lewis's five-stage development framework, encompassing existence, survival, success, take-off, and resource maturity stages, provides a framework for analysing SMEs' operational processes and strategies. Although not strictly adhered to, these stages serve as a reference point for understanding SMEs' organisational structures, priorities, and growth trajectories. Traditional research on competitive advantage assumes a firm can achieve competitive advantage through a low-cost position or a differentiated service from a resource-based view (Barney, 2001; Porter, 2011). SMEs can gain competitive advantage from both internal dynamic capability and external adaptive capability, and an aid to this is the SME
ecosystem. It is recommended that the resource-based theory can be enriched by taking into account these other dimensions.

The literature also acknowledges the diversity in SME development trajectories, with owners' goals serving as major determinants. Growth, encompassing financial expansion and market diversification, emerges as a central theme, along with considerations for employee quality, customer satisfaction, and supportive networks. Moreover, the review highlights the evolving nature of success metrics among SMEs, increasingly incorporating diverse non-financial measures. These encompass both internal dimensions, such as organisational and network capabilities, and external factors, including customer relations and socio-cultural contexts.

In light of these findings, there is a growing recognition of the need to explore SMEs' self-identification and their multifaceted views on success. The role of networks, particularly the concept of 'coopetition,' emerges as a significant determinant of success, warranting further investigation from the SMEs' perspective. These aspects should constitute the primary contributions of any future research in this field, aiming to provide a comprehensive understanding of SME success within the service sector and beyond.

References


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