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An Analysis upon Different Accounting Practices of SMEs and It's Influences on Usage of Financing

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***Abstract* – This study seeks to examine the accounting practice of small and medium sized enterprises and its effect on access to finance. It identifies the sector as the key to unlocking the economic potentials of the country. However, the sector is constrained by a number of factors which include among others minimum or poor accounting practice and difficulty in accessing credit facilities.**

The study revealed that the majority of the studied firm has no formal accounting practice. The study also revealed that the major sources of finance available for the establishment and expansion of SMEs are personal saving, microfinance, money from friends or relative, iqub and less from banks. The result of ordinary least square regression evidences that variables such as capital, manager education level and age of the firms are the significant determinants of firms' accounting practices whereas the problems significantly associated with access to bank credits are the demand for collateral, accounting practice or formal accounting information and age of the firm.

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INTRODUCTION

In order to understand the role of small and medium practices (SMPs) in providing business support to small- and medium-sized enterprises (SMEs),1 it is important to set out the general context within which this key role operates. SMEs are now crucial to most developed and developing economies. For example, in the European Union, SMEs contribute to over 99% of all enterprises and 100 million jobs, representing 67.1% of private sector employment. Extant theory and evidence demonstrates that owners and managers of SMEs utilize external sources of advice and support services primarily because of a gap in their internal resource base. SMEs need to have competencies in order to survive in a changing environment and buying-in resources, in terms of advice and support, is a dominant approach for their survival and development. It is this resource gap and changing environment faced by SMEs that creates a role for SMPs as key business advisers. The type, nature and future of this role is, however, open to question.

SMEs themselves are a heterogeneous group, possessing different size, age, sector, location and growth profiles as well as run by owner-managers with different capabilities and motivations. These characteristics inevitably influence the type of external service provision they will seek. The statutory requirements and regulatory regimes in which SMEs operate have also changed over time. For example, in a number of jurisdictions, whilst there has been a relaxation in the statutory audit provisions, there have been changes in regulation in other areas, such as employment rights and environmental regulations. Despite movements to reduce the regulatory "burden" on SMEs (International Bank for Reconstruction and Development/The World Bank, 2009) the market for advice and support is substantial. In the UK, for example, it is estimated that businesses spend at least £1.5bn to help them deal with regulations (Department of Business, Enterprise and Regulatory Reform.

It is into such a dynamic environment and marketplace that accountants, and particularly SMPs, seek to provide advice to businesses. Hence, the market for advice, deriving from regulations that affect SMEs, is constantly changing. Given the change in the market conditions for advice this has led many accountants to enter into providing a wider range of services to SMEs. This has major implications for those accountancy practices seeking to engage with SMEs. Over time, the amount and type of advice from accountants has evolved according to both the needs of SMEs and the strategic intent of accountants.

The accountancy industry has undergone dramatic changes in the provision of statutory, compliance work. For example in the UK the number of registered audit firms has been gradually declining. The overall number of audit firms registered in 2008 (8,179) is 25.7% lower than the number in 2003 (11,006). Related to this, in terms of fee income for many accountancy practices, the picture has also changed. For example, in the UK over the past five years, the "Big Four" have experienced a steady increase in the proportion of fee income from non audit work for non audit clients. In contrast their fee income from non audit work to audit clients has been falling.

There are varying worldwide definitions of what constitutes an SME although they tend to use the same metrics of employment, turnover and asset base. For example, the European Union defines a SME made up of enterprises which employ fewer than 250 persons (micro 1–9; small 10–49, medium 50–249) and which have an annual turnover not exceeding 50 million euro, and/or an annual balance sheet total not exceeding 43 million euro.3 In the USA, the employment size threshold is 500 people, with small firms employing 100 people.

The role of finance has been viewed as a critical element for the development of small and medium-sized enterprises. Previous studies have highlighted the limited access to financial resources available to smaller enterprises compared to larger organisations and the consequences for their growth and development. Typically, smaller enterprises face higher transactions costs than larger enterprises in obtaining credit. Insufficient funding has been made available to finance working capital. Poor management and accounting practices have hampered the ability of smaller enterprises to raise finance. Information asymmetries associated with lending to small scale borrowers have restricted the flow of finance to smaller enterprises. In spite of these claims however, some studies show a large number of small enterprises fail because of non-financial reasons.

The purpose of this study is to discuss the focus of previous studies on the relation between finance and small and medium-sized enterprise development and to identify some of the gaps in our knowledge. While a considerable amount is known about the characteristics and behaviour of small and medium-sized enterprises, this knowledge continues to be imperfect and a large number of questions remain unanswered in relation to finance and small enterprise development. This study discusses some of the issues raised by previous research and points to newer areas that can fruitfully be researched.

SMALL AND MEDIUM-SIZED ENTERPRISES : AN OVERVIEW

SMEs are defined as non-subsidiary, independent firms which employ fewer than a given number of employees. This number varies across national statistical systems. The most frequent upper limit is 250 employees, as in the European Union. However, some countries set the limit at 200 employees, while the United States considers SMEs to include firms with fewer than 500 employees. Small firms are generally those with fewer than 50 employees, while micro-enterprises have at most ten, or in some cases five, workers.

Financial assets are also used to define SMEs. In the European Union, SMEs must have an annual turnover of EUR 40 million or less and/or a balance-sheet valuation not exceeding EUR 27 million. SMEs play a major role in economic growth in the OECD area, providing the source for most new jobs. Over 95% of OECD enterprises are SMEs, which account for 60%-70% of employment in most countries. As larger firms downsize and outsource more functions, the weight of SMEs in the economy is increasing. In addition, productivity growth – and consequently economic growth – is strongly influenced by the competition inherent in the birth and death, entry and exit of smaller firms. This process involves high job turnover rates – and churning in labour markets – which is an important part of the competitive process and structural change. Less than one-half of small start-ups survive for more than five years, and only a fraction develop into the core group of high-performance firms which drive industrial innovation and performance.

Most SME jobs are in the service sector, which now accounts for two thirds of economic activity and employment in OECD countries. Smaller firms are found particularly in wholesale and retail trade, the hotel and restaurant business, communications and business services, and construction. SMEs also account for a high percentage of manufacturing firms in many OECD countries and provide at least half of OECD manufacturing employment. Smaller firms are increasingly present in technology-intensive industries such as information and communications technology (ICT) and biotechnology.

SMEs predominate in the important strategic business services subsector, including services relating to computer software and information processing, research and development, marketing, business organization and human resource development. Increased outsourcing by major manufacturing firms, combined with new technologies that have allowed SMEs to win market niches, has led to 10% annual growth in these knowledge-based services in recent years. The fact that the average firm size in strategic business services is a fraction of the average size of firms in manufacturing or in the economy as a whole is an indication of the importance of SMEs in this field.

ACCOUNTING SYSTEMS

In small enterprises there can be different kinds of accounting systems such as external, internal and tax accounting. Annex 3 summarizes data per Member State concerning accounting system requirements for small enterprises.

The accounting framework lays down the concepts and principles that are the basis for preparing and presenting the external financial statements of an enterprise. These principles may not necessarily be applicable in all Member States to all enterprises all the time because of e.g. the size of the enterprise or different user's needs. Therefore, each enterprise needs to decide which principles it considers most important and applicable to its particular circumstances and business environment.

The principles presented below are not ranked in order of importance but are classified as either accounting principles or principles for drawing up external financial statements. Many of the principles described below are based on the Fourth Directive (78/660/EEC) because these are often already used by businesses that are strictly outside the scope of the Fourth Directive as well as those within the scope of the Fourth Directive. Annex 4 provides an overview per Member State on what kind of accounting framework is applied to small enterprises.

E-ACCOUNTING PRACTICES

The Accounting Act of 1997 and further guidelines issued by the Accounting Board in 2000 provide an institutional setting for the use of electronic data media in financial accounting for registering, transferring and storing data as well as reporting information electronically. Thus, source documents and accounting records exist in digital form instead of on paper in an electronic accounting system. This exploratory research will try to further the understanding of the factors influencing small and medium-sized accounting agencies to adopt e-accounting as well as study the impact of e-accounting in agencies that have adopted e-accounting.

Accounting plays a critical role in the success or failure of contemporary business institutions. Accounting systems are responsible for recording, analyzing, monitoring and evaluating the financial condition of companies, preparation of documents necessary for tax purposes, providing information support to many other organizational functions, and so on. Prior to the advent of personal computers, businesses were limited to manual methods for keeping track of financial data. According to Tavakolian (1995), the manual accounting systems consisted of paper ledgers, typewriters and calculators. Typewriters were used to type invoices and cheques, and all calculations were performed using calculators. However, with this system it was possible for errors to be introduced into the data since they could go undetected for quite some time. Like many other industries, the accounting industry changed with the arrival of personal computers. A computerized accounting system is able to handle financial data efficiently, but the true value of an accounting system was that it was able to generate immediate reports regarding the company. What is therefore e-accounting practice? E-Accounting refers to Electronic Accounting, a term used to describe an accounting system that relies on computer technology for capturing and processing financial data in organizations. In the literature, two more terms have been used to describe E- accounting: computer-based Accounting System and Accounting Information System (AIS). Stefanou (2006) observed that although accounting information system does not require a computer to function, the computerization of the accounting function, the term AIS is used primarily to denote the computer-based AIS. In this study the terms E Accounting and financial information system are used to refer to any accounting system that depends on Information and Communication Technology (ICT) for performing its information system functions. Unlike other information systems, Accounting was one of the first functional areas to benefit from computerization when computers were initially introduced to organizations.

LITERATURE REVIEW

The literature covering SME-accountant relations spans academic, government and practitioner fields. Essentially, there is a well developed corpus of literature that has considered various aspects of SME-accountant relations. There is also a large amount of information and marketing literature from accountants and accountancy professional bodies themselves, much of it available on the web and free of charge.

Within the literature, the specific term Small and Medium Practice (SMP), as previously mentioned, is relatively scarce and has only recently gained currency amongst professional bodies and is almost absent in the academic literature. For example, a search in Google Scholar produced only 267 results using the research term SME SMP accountant and most of the results within this were irrelevant or tangential to the study.

In examining the demand for external business advice and support by SMEs from SMPs, it is important that the broader context of business advice seeking by SMEs is presented. There has been a growing literature on the motivations and advice seeking activities of owner-managers. Essentially, this literature points to the reluctant, or at best circumspect, behavior of owner managers in readily seeking advice.

Research has found that a major stimulant for SME external advice has been growth in the amount of government regulation and demands by SME clients for monitoring and quality control. This is not merely confined to financial compliance. A number of studies have identified the growth in the amount of regulation and this has generated a derived demand for external advice and support, such as in relation to employment, health and safety and environmental regulations.

Challenges facing the financial accounting and the accounting profession have been discussed among researchers. There seems, however, to be a number of concepts used in the literature relating to the use of technology in financial accounting.

Accounting systems are responsible for analyzing and monitoring the financial condition of firms, preparation of documents necessary for tax purposes, providing information to support the many other organizational functions such as production, marketing, human resource management, and strategic planning. Without such a system it will be very difficult for SMEs to determine performance, identify customer and supplier account balances and forecast future performance of the organization.

Heidmann et al. (2008) explored the role of management accounting in strategic sense making. Their research provides evidence that managers do not primarily use management accounting to generate information relevant to strategic issues. Instead, this research suggests that managers use management accounting to find specific information that helps them to substantiate information about strategic issues from informal sources. Moreover, effective management accounting focuses organizational attention, helps middle managers to develop interpretations of strategic issues and provides information that enables top managers to identify and discuss these issues.

METHODOLOGY

Quantitative research approach was adopted to carry out this study particularly the survey design. The reason for the adoption of this approach includes; there is the cause and effect relationship in the study, to make generalization from a sample to a population, it is an efficient way of collecting information from a large number of respondents, Statistical techniques can be used to determine validity, reliability, and statistical significance, because they are standardized they are relatively free from several types of errors, they are relatively easy to administer, there is an economy in data collection due to the focus provided by standardized questions. The nature of the survey is the cross-sectional, because it is possible to obtain the desired information at one time.

The accounting practitioners were selected on the basis that they were sensitive to environmental issues. All the practising firms were registered with ACCA and most of the accountants were members of ACCA. An international element was introduced at the request of the funders, resulting in the inclusion of perspectives from Canada, Hong Kong, the Netherlands and the UK. Access was partially supported by ACCA.

An initial literature review informed an interview schedule for SMPs, which was varied according to the respondent type. The interview guide for the core data of the practising accountants.

The interview transcripts were coded according to the emerging themes relating to the research questions. The data were treated as socially constructed accounts of the SMP/SME relationship and advisory role in relation to environmental sustainability, and were analysed accordingly. Additional supporting documentation and Web-based material were gathered where possible but this is very limited owing to the lack of external reporting by small businesses and the confidential nature of the material handled by accountants. The research team included individuals with specialist knowledge in accounting, sustainability accounting, and sustainability in SMEs, ensuring that the necessary interdisciplinary approach to the topic was achieved.

A research design provides the basic directions for carrying out the project. In particular, a research design should provide relevant information that will most efficiently and effectively address the research questions or hypotheses.

The firms in the sample were randomly selected from each sub-city database of firms. The sample was stratified by firm size class and economic activity. The number of firms in each of these strata of the sample was adjusted to increase the accuracy of the survey across activities and size classes.

CONCLUSION

SMEs have been fully recognized by governments and development experts as the main engine of economic growth and a major factor in promoting private sector development and partnership. The development of the SME sector therefore represents an essential element in the growth strategy of most economies and holds particular significance in the case of Nigeria. SMEs not only contribute to improved living standards, employment generation and poverty reduction but they also bring about substantial domestic capital and achieve high levels of productivity. From a planning standpoint, SMEs are increasingly recognized as the principal means for achieving equitable and sustainable industrial diversification and growth.

This study is limited to small and medium-sized accounting agencies for which some adoption factors, assumed to be relevant in this context, are tested. There is a danger that additional significant factors have not been included in the study, and any comments and suggestions for further improvements on this ongoing research project are very welcome.

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