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Barriers and Catalysts to Sound Financial Management Systems in Small Sized Enterprises

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Introduction

Despite the increasing amount of research in management accounting in the past decade, little was known of its form and effectiveness within Small and Medium sized Enterprises (SMEs). Whilst empirical studies have been devoted in these years on larger enterprises (e.g. Ezzamel et al 1994, Anderson 1995, Moden and Hamada 1991) it has been only more recently that research has been directed towards the financial management systems that operate within SME's (Lyabert 1998, Mitchell et al 1999).

This study focused upon the small business sector of the economy and it had three main aims: firstly, it investigated the role, function and scope of the financial management systems operating within small firms (1). Secondly, it attempted to understand why in certain firms robust financial systems exist, whereas in others they are seen to be weak (2). Finally, the role of training and other support needs for sound financial management systems were investigated (3). Included within the analysis was the consideration of whether sound accounting systems are contingent upon such factors as the role of the accounting profession, in-house accounting functions, the characteristics of the owner/director and business development training and support.

The study was based on small businesses in central and north Scotland. The parameters selected for categorising small businesses were firms with employees of 50 or less (one of the parameters defined by the Companies Act 1985) whilst only the profit making sector was considered. The study was based on in-depth case studies with 12 small businesses using structured interviews. Following this initial study a postal questionnaire was sent to over 1,500 small businesses in central and north Scotland during 2000 and 2001 with a response rate of 26.91%. Whilst the organisations that responded varied in relation to size, 86.5% of the entities had been operating for more than five years.

Key findings

1. The bookkeeping systems adopted for financial accounting scored positively in that there was a significant uptake of these systems. There was a high preponderance of integrated computer systems adopted by firms in the study.

2. Management accounting systems did not score as well as financial accounting overall with the former having a reduced uptake compared to the latter.

3. Long established firms were as likely to be dissatisfied with their financial and management accounting systems as more recently established entities.

4. Smaller businesses were most likely to be dissatisfied with their management accounting systems.

5. The accounting profession was not scored highly in relation to adding value with an apparent over emphasis on financial reporting and year end accounts and little assistance on management accounting information, systems and business strategy development.

6. The principal catalysts to sound financial management systems within the small firms sector appeared to be;
- Computerised accounting systems (for periodic financial reporting).
- Highly motivated owners/directors of firms.
- Qualified internal accounting staff.
- Proactive external accountants.
- Pressure from providers of finance, including business angels.

7. The following were seen to act as barriers to the development of robust systems -
- The lack of internal accounting staff, or where there were such staff but they were unqualified, untrained or unmotivated, which could act also as a significant barrier to the development of sound systems.
- Some accountants did not appear to add any value to, and appeared to lack an awareness of the needs of, small businesses.
- Poor targeting and delivery of training and other support could act as a disincentive to systems development.

8. It should be noted that some of the groups are both catalysts as well as barriers. Owners/directors of firms could act as significant barriers to the development of sound financial management systems, particularly where they felt inadequate or uncomfortable with financial information whilst other owner/directors were highly motivated in developing their systems.

Each of the key findings are discussed in further detail as part of the summary of key issues from the research below.

Summary of Key Issues

1. The role, function and scope of the financial and management accounting systems operating within small firms.

A number of conclusions can be drawn from this research study. However, generalising from the findings has to be considered in the light of problems encountered with multiple variables that create difficulty in isolating cause and effect. Multivariate analysis techniques have not been adopted here and could be the focus for further research. Nevertheless, some useful insights are provided that may assist the small business sector, the accountancy profession and the development and support agencies, in providing more effective advice and support in the development of sound financial management systems within the sector.

The bookkeeping systems adopted for financial accounting scored positively in the study. This may well be linked to the high preponderance of integrated computer systems adopted by firms in the study. Of course, the principal catalyst here may well be the demands of compliance reporting to satisfy the requirements of legal and taxation authorities and the providers of finance.

In contrast, management accounting systems did not score as highly as financial accounting overall with for example respondents scoring their financial accounting system highly (79.1% scored either 4 or 5) whilst the scoring for management accounting information was lower (62.2% scored 4 or 5). Periodic reporting was seen to be a positive feature of small businesses accounting procedures (78.7% scored 4 and 5 regarding satisfaction with this characteristic), which may again be linked to those organisations with integrated computer packages where periodic reporting is readily available as part of the financial reporting software.

Budgeting systems (cash or profit) were only adopted by a small majority of the respondents, a significant number (17.6%) of who were not very positive about their systems (scoring between 0 and 2 regarding satisfaction with budgeting). Similar results were found for performance indicators (25.2% scoring between 0 and 2). Product or service costing was not utilised by just over one third of the respondents. In relation to major decision making, just over one third of the firms did not have any financial evaluation undertaken. Integrated computer packages may well serve the book-keeping and financial reporting aspects of this study but are not suited to the specific needs of management accounting requirements which are not standardised (unlike double entry bookkeeping reporting systems).

One recurrent theme of the study is that the smaller as well as the long established firms are likely to be dissatisfied with their financial and management accounting systems. For example, in relation to the use of periodic reporting, it was noted that 14.3% of the smaller firms (between 1 and 10 employees) were dissatisfied with this area of their management information systems, whilst only 6% of the larger firms (between 31 and 50) were dissatisfied. In contrast, none of the younger firms (less than 2 years old) were dissatisfied with their periodic reporting, whilst 9.4% of the older firms (greater than 5 years old) were.

An argument could be made that older firms may be less dynamic regarding innovation with accounting systems. It may be that these firms have ceased growing and a level of stagnation has set in. One would have expected that, in comparison to younger firms, established businesses would have recorded higher scores as their systems had some time to evolve. This was not the case with many of the younger organisations appearing capable of installing management accounting systems successfully, such as product and service costing and performance indicators, perhaps it would be better to focus attention on providing assistance to smaller as well as longer established businesses. A counter argument to the above could be that for a number of the accounting processes the young firms may be too young to realise the need for accounting systems and that it is only with maturity that the need is recognised. This therefore could lead to young businesses stating their satisfaction with their accounting systems and also to more mature firms being dissatisfied.

2. Why in certain firms robust financial systems exist whereas in others they are seen to be weak?

Influences to sound financial management systems
Evidence from the structured interviews suggested that the principal influences to sound financial management systems within the small firms sector were the following:

- Computerised accounting systems.
- Highly motivated owners/directors of firms.
- Qualified internal accounting staff.
- Proactive external accountants.
- Pressure from providers of finance, including business angels.

Barriers to sound financial management systems
In a number of circumstances the same groups that act as catalysts could also act as barriers to the development of robust systems. In particular, it would appear that some members of the accounting profession need to reassess their approach to servicing the needs of this important sector of the economy. Many firms expressed disappointment at the limited support and advice made available by some of their external accountants. Particularly, they perceived that they received little advice on development of their financial systems, especially management accounting aspects.

Such aspects may be critical to the long term development, success and growth of small firms into medium sized and large entities. Many owners felt that their accountants focused primarily upon the year-end accounts (which they saw as merely replicating their internal accounts) and, if this is the case, it may be the result of short-term thinking on the part of such accountants. Perhaps such accountants should seek to be more proactive in offering, possibly on a loss-leader basis, a wide range of advice and support to encourage firms to take maximum advantage of the facilities provided within their computerised accounting systems.

Certainly, it should be of concern that a number of the interviewed firms felt that their accountants did not add any value to, and lacked an awareness of the needs of, their businesses. This was confirmed by almost half the firms responding to the questionnaire with 49.1% scoring between 0 and 2 when asked whether their accountant added value to the business. In addition 53.4% scored between 0 and 2 when asked about their accountants assisting with business strategy and 44% scored lowly regarding assistance with accounting systems development. Somewhat surprisingly, and running counter to this, almost nine out of ten firms would not seek to change their accountant. This would appear to suggest either complacency on the part of the owners/directors of these firms or perhaps a feeling that 'all accountants were the same', and therefore it was not worth 'replacing' their present accountant. However, one case study in the interviewed group illustrated powerfully the role of 'change agents' in this type of scenario, where a business angel demanded appropriate accounting systems and required the firm to change, and recommended who should replace, its external accountant. The new accountant 'has good business sense and takes ownership and responsibility'. He also runs regular 'business lunches' at his office with other small businesses. The firm has now grown dramatically after several years of loss-making activity.

It would appear that owners/directors of firms could act also as significant barriers to the development of sound financial management systems, particularly where they felt inadequate or uncomfortable with financial information. These feelings may be the result of a number of factors such as a lack of training, the presentation of information in a form difficult to understand and the poor communication skills of accounting advisers. This feeling of inadequacy could lead to little use being made of financial data, with 'lack of time' often quoted as the reason for such owners/directors lack of development of their financial skills.

Similarly, the lack of internal accounting staff, or where there were such staff but they were unqualified, untrained or unmotivated, could act also as a significant barrier to the development of sound systems (qualified staff only supported 45.7% of the firms). Here the provision of relevant and targeted business training could be expanded to meet the needs of the small business sector. Greater flexibility in delivery and appropriateness of training material would meet with a positive response from this sector of the business community. It would appear also that, if such training was linked to adviser support, it could help overcome some of the problems identified in this section.

3. The role of training and other support needs for sound financial management systems

Internal accounting functions

The respondents were asked about their internal accounting function. It was noted that 17% of the firms did not employ any accounting staff and, of those that did, 37.5% of the accounting staff did not hold any form of qualification. Therefore, 'qualified' staff supported only 45.7% of firms, with an HNC being considered as the lowest level of 'qualification'. However, over a quarter of the businesses employed a consultant who visited on a regular basis (normally monthly or quarterly). The concept of regular visits by a consultant was seen by a number of the case study directors as having a significant influence on the development of their firm's financial management systems.

Of interest to the accounting profession should be the significant percentage of firms that do not have any internal accounting support through qualified staff. There would appear to be a gap in the market whereby a 'para-accountant' could serve the small business community effectively.

Support from an external accountant

It was interesting to note that 72.6% of respondents felt strongly that the final accounts merely replicate their own internal accounts. This raised the question of why the businesses found the final accounts useful, other than their role in validating, and providing confidence in, the internal figures.

Accountants appeared to perform poorly in the provision of advice on both systems development and strategic thinking/planning. In terms of assistance in developing accounting systems, 44.0% of businesses scored the accountant low. In relation to the provision of advice on business strategy, 53.4% of firms gave their accountants a low score, with 20.1% giving them a zero rating.

Perhaps the most significant question and result was the perceived added value provided by accountants, where 49.1% of respondents did not feel that their accountants add any value to their businesses.

The directors of the companies visited were not slow in making their feelings known about their external accountants. Below are quotes from a number of the interviews:

> '...he never volunteers advice and will state opinion only where asked. Furthermore he offers no assistance in the development of the accounting system...and adds no value to the business'.

> 'The accountant should be a facilitator of change but accountants seem prepared to be observers rather than participators. Accountants could provide better advice on the financial software packages'.

> 'I don't know what I am paying for, he is not proactive. He merely keeps the taxman off my back'.

One final point paradoxically was that in the questionnaire where a low value was given for the value added by the accountant, the vast majority of the firms would not consider changing their accountant. This raises the question: why would they not change accountants? Is there a perception that it is more bother than it is worth, or perhaps are small firms unaware of the enormous influence an effective accounting consultant could have on their business.

One business that did change their accountant received enormous assistance in developing management information. In this case they moved from a financially focused accountant to a management accountant. They stated:

'The accounts were prepared nine months after the year-end and were my only source of data regarding profitability. I did not consider the external accountant to be proactive and was a poor communicator.

To remedy this situation, and because the business had grown, I decided to employ a CIMA qualified member of staff. This decision to take on a qualified accountant was driven mainly by the lack of information both to inform business strategy and to control the operations of the business. This had proved to be a successful strategy as the internal accountant is now developing the firm's accounting software and systems. Previously I had no budgeting, costing, performance measurement, or debt collection systems in place, but now these are being developed.'

Support from business development bodies

Firms were asked to score their experiences of development body training and support but only 54 (13.5%) of the respondents had received any such assistance. The majority found the training useful (71.2% scored the training highly), although half of them found the materials inappropriate to the needs of their businesses. Assistance in developing accounting systems was well received by 66.6% of those receiving such support.

Highly motivated owners/directors

One last feature apparent at several of the interviews was that financial systems have been developed by the managers themselves, even though they have no accounting qualifications or training. Many businesses were run by highly motivated entrepreneurs who not only marketed their specialisms, but also dabbled in business management areas where weaknesses were perceived. It was interesting to note the number of directors who, having attempted different support mechanisms, ended up tutoring themselves.

Conclusions

It would appear that the accounting profession needs to reassess its approach to servicing the needs of this important sector of the economy. Many firms expressed disappointment at the limited support and advice made available. Particularly, they perceived that they received little advice on development of their financial systems, especially management accounting aspects. Such aspects may be critical to the long-term development, success and growth of small firms. Many owners felt that their accountants focused primarily upon the year-end accounts (which they saw as merely replicating their internal accounts). Perhaps such accountants should seek to be more proactive in offering, possibly on a loss-leader basis, a wide range of advice and support to encourage firms to take maximum advantage of the facilities provided within their computerised accounting systems.

It should be of concern that many firms believed their accountants did not add any value to, and lacked an awareness of, the needs of their businesses. Somewhat surprisingly, and running counter to this, almost nine out of ten firms would not seek to change their accountant. This would appear to suggest either complacency on the part of the owners/directors of these firms or perhaps a feeling that 'all accountants were the same', and therefore it was not worth 'replacing' their present accountant.

Similarly, the lack of internal accounting staff or the existence of unqualified staff could act as a significant barrier to the development of sound systems. The emergence of 'para-accountants' may be an effective support to this community. Also, the provision of relevant and targeted business training linked to adviser support could be expanded to meet the needs of the small business sector.

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