

**ACCOUNTING PRACTICES OF SMALL AND MEDIUM SIZED  
ENTERPRISES AND ITS EFFECT ON ACCESS TO FINANCE IN  
WOLKITE**

*A Research paper Submitted to the Department of Accounting and Finance in Partial Fulfillment  
of the Requirements for the Award Bachelor of Degree in Art (BA) in Accounting and Finance*



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**August, 2021**

## **ACKNOWLEDGEMENT**

It is the grace, mercy, charity, forgiveness, help and kindness of the almighty God- Jesus Christ that made me still alive ,achieve this success and strength and to go through all the difficult time. Next to this, I would like to thank my advisor Miss Nesriya, she has guided me and provided me her valuable comments during each chapter of the study which helped me a lot to move my study on track and finally to complete it .Additionally, I need to say thank you to the participating individuals who gave me such great support, and the respondents, without whom this research would have not been possible. Finally, I am highly indebted to my family and friends for their encouragement, prayer and assistance as well as for their support in completing the study. I would like to extend my sincere thanks to all of them.

To any others I have omitted to mention, my grateful thanks. I thank you all!

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## **List of Acronyms**

**CVP**- Cost volume profit

**CSA**-Central statistical agency

**GC**- Gregorian calendar

**GDPs**- Gross domestic products

**GNP**- Gross National Product

**IASB**- international accounting standard board

**ILO** - International Labor Organization

**MSMEs**- Micro, small and medium sized enterprise

**NICs**-New Industrialized Countries

**OECD**- Organization for Economic Cooperation and Development

**Plc.**-private limited companies

**SMEs**- small and medium size enterprises

**UK**-United kingdom

**UNDP**- United Nations Development Program

**US\$/US**-United States dollar

## **ABSTRACT**

This study seeks to examine the accounting practice of small and medium sized enterprises and its effect on access to finance in Wolkite. 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. For the achievement of the objective of the study quantitative research approach particularly survey design were used and the data obtained were analyzed using descriptive statistics.

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 in Wolkite are personal saving, microfinance, money from friends or relative, Iqub and less from banks. 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

# CHAPTER ONE

## INTRODUCTION

### 1.1 Background

Small and medium sized enterprises are an important ingredient for stable and equitable growth in any national economy. Ethiopia takes the development and expansion of SME's as the main way to solve many of the social problems. WOLKITE (capital city of Gurage zone) is a town with alarming socio-economic problems. At present various reforms and development activities are being carried out. One of these is the promotion and development of SME's in the town. The program has been started since (2002/03 G.C) to enhance the promotion of the sector, emphasizing on employment creation through the development of SME's (Wolkite town trade and investment office 2020). Yet despite specific global efforts to strengthen the SME sector, these businesses face a number of stifling financial and regulatory barriers, particularly in developing countries. In Ethiopia one of the main problems of SME's may be their access to finance and accounting practices.

Since the 1960s to date, SMEs have been given due recognitions especially in the developed nations for playing very important roles towards fostering accelerated economic growth, development and stability within several economies. They make-up the largest proportion of businesses all over the world and play tremendous roles in employment generation, provision of goods and services, creating a better standard of living, as well as immensely contributing to the gross domestic products (GDPs) of many countries (OECD 2000).

However, it appears that considering the enormous potentials of the SMEs sector and despite the acknowledgement of its immense contribution to sustainable economic development, its performance still falls below expectation in many developing countries (Arinaitwe2006).

Despite the importance of financial reporting, management accounting and control practices, it is unfortunate to find that these practices are often inadequate and lacking among SMEs. Except for yearly taxation returns and some form of profit and loss statements, other statements

such as balance sheet, cash flow statement, fund statement, production report, variance report, are infrequently used. This rather limited usage of financial and management accounting reports could be attributed to SMEs' inability to employ professional managers with functional specialization especially in the financial area due to their limited financial resources. Without adequate, effective and timely financial reports and analysis, the SMEs are losing out on the benefits from those practices such as improved monitoring of financial health and progress, improved ability to anticipate fortunes or failures, better assessments of financial risks and greater ease in financial planning and control. Most importantly, in the context of SMEs requiring extra capital to grow, regular financial reports can provide indications on their ability to produce steady cash flows and to service debt. It has been established that the use of appropriate financial reporting and management accounting practices could be one of the determinants of company survival particularly SMEs (Gorton, 1999; Holmes, 1991). To ensure the contribution of SME's to the economy the enterprise should perform efficiently, which is effective through practicing accounting system and having an access to finance. In Ethiopia these enterprise may not practice accounting or not practicing formal accounting system and has no well-developed access to finance. The aim of this paper is to examine the accounting practice of SME's and its effect on access to finance in Wolkite.

## **1.2 Statement of the problem**

It appears that considering the enormous potentials of the SMEs sector, and despite the acknowledgement of its immense contribution to sustainable economic development, its performance still falls below expectation in many developing countries (Arinaitwe2006).

SMEs frequently lack access to institutional credit (World Bank 1978), causing them to encounter high financing costs and high failure rates (Byron &Friedlob1984).

The possible reasons for SME failures include among others 1) the poor management and/or administrative skills of the owner/manager, 2) insufficient capital invested by the owner, 3) an over-reliance on external borrowings, and 4) poor record-keeping, and etc. (Brooks, Collings& Gonzales 1990). Poor record keeping and inefficient use of accounting information are a major

cause of the above according to Berryman (Berryman1982 quoted in Siop1997, Walton 2000, Wichmann1983, World Bank 1978). The inefficient use of the accounting information to support their financial decision-making and the low quality and reliability of financial data are part of the main problems of SMEs (Ubonratchathanee University 2000).

Accounting information signals that decisions are needed, and provide information useful to making decisions (Gibson 1963 quoted in Thomas & Evanson1987; Report of the study group on the objectives of financial statements, American Institute of Certified Public Accountants, 1972 quoted in Lothian 1976). Accounting information is used to assess the profitability of alternative courses of action, measure performance, and evaluate the position of enterprises in term of profitability, liquidity, activity and leverage. It can be used to improve SME performance, especially financial decisions.

Different capital structures cause different degrees of financial risk. Different alternative financial plans affect SMEs' performance differently. Thus, proper accounting is a key to small business success (Wichmann 1983).

SMEs lack of access to capital and high interest rates charges are partially the result of incomplete (or no) accounting records, and the inefficient use of accounting information.

Poor record keeping and accounting information make it difficult for financial institutions to evaluate potential risks and returns, making them unwilling to lend to SMEs (WorldBank 1978). As a result, SMEs pay high interest rates or fall back on the middlemen or money lenders, whose loans are costly and often restrictive (Institute for Small and Medium Enterprises Development). The misuse and inaccuracy of accounting information causes SMEs to inaccurately assess their financial situation, and make poor financial decisions, as well as leads them to face with the high failure rate (Byron 1976).

While the performance levels of small businesses have traditionally been attributed to general managerial factors, such as manufacturing, marketing and operations, accounting systems may have a strong impact on small business survival and growth. The literature on financial and accounting practices is scarcer than long term investment and financing decisions (Howorth,

1999, 2003; Peel and Wilson, 1996), yet it occupies the major share of a financial manager's time and attention (Gitman, 2000).

A large number of business failures have been attributed to inability of financial managers to plan and control properly the current assets and the current liabilities of their respective firms (Dodge and Robbins, 1992; Ooghe, 1998). In particular, the small firms may face serious problems due to the operating conditions and specific characteristics.

The main factors that contribute to success or failure of small business are categorized as internal and external factors. The external factors include financing (such as the availability of attractive financing), economic conditions, competition, government regulations, technology and environmental factors. The internal factors are managerial skills, workforce, accounting systems and financial management practices. SMEs often face problems with regard to access to finance which is associated with accounting practices. The problem the enterprises faces are that associated with accounting practices includes; it is very difficult to give information on their income and expenses (they do not know whether they have lost or profited from their business activities), in presenting their financial position, management decisions and this leads problem on access to finance.

These problems evidence the need to undertake extensive research on the accounting practice of SME's and its effect on access to finance.

### **1.3 Research Questions**

- 1) How to contract an empirical study of the accounting practice of SME and its effect on access to finance?
- 2) What are the factors of accounting practices of SME?
- 3) What are the factors that affect access to credit of the SME?
- 4) What are the sources of credit available to SMEs and the types of finance used?

## **1.4 Objective of the study**

The general objective of the study is to construct an empirical study of the accounting practice and its effect on access to finance of SME's in Wolkite.

### **1.4.1 Specific objective of the study**

**Specifically the study has the following aims:**

- ✓ Determining Whether SME does maintain formal accounting practice.
- ✓ Examine the determinants of the accounting practice of the SME.
- ✓ Examine the determinants of the access to credit of the SMEs.
- ✓ Identify the source of credit available to SMEs and the types of finance used.

## **1.5 Significance of the study**

This study examine the accounting practice of SME and its effect on access to finance, in order to give meaningful insight and contribute to efforts aimed at expanding SME in the town and transforming small enterprises to medium sized enterprises. Therefore the study performed will have the result of strengthening the relationship between SME's and banks by specifically identifying the main barriers between them, provide knowledge to SME about the importance of accounting practices, it fill the research gap in the area and provides the basis for further research.

## **1.6 Scope of the study**

The study only cover the Wolkite town SME's accounting practices and access to finance of the firm. The scope of this study focus on SMEs in Wolkite specifically business included are service, retail and wholesale.

## **1.7 Limitations of the study**

During the study time some of the limitations were faced by the researcher. To cite the limitations; absence of complete and organized information about the enterprise from

sub-city, difficulty to get the address of the enterprises to be studied and there was many challenges to get the required data from some firms.

## **1.8 Organization of the paper**

The paper is organized as follows; Chapter one Introduction Chapter two reviews of the Literature, chapter three is research methodology, chapter four results and discussions of descriptive analysis, chapter five conclusions and recommendations.

## **CHAPTER TWO**

### **REVIEW OF THE LITERATURE**

The previous chapter presents the background of SME's and the objective of the paper which is to examine accounting practices of SME and its effect on access to finance. This chapter presents the theoretical literature including definition of SME's; empirical evidence on accounting practice of SME's and access to finance and research gap.

#### **2.1 Theoretical perspective**

Development strategists have advocated the progressive use of small and medium enterprises (SMEs) to accelerate the pace of economic growth especially in the developing countries of the world (Daodu, 1997). Most African countries are basically agrarian societies with the majority of the populace engaging in agro-related activities such as farming, livestock rearing, agro forestry and fishing (Osinowo, 1997). With little capital to invest, it seems obvious that the process of industrialization should be based on the development of the SMEs to link agricultural production with manufacturing activities. This requires specific incentives to assist in the development of the SMEs subsector, which include among others easy accessibility to credit, provision of infrastructural facilities, industrial extension services and development of production capacity based on locally developed or adapted technology and locally designed equipment and spares (Ekpenyong, 1992; 1997).

The need to promote a vibrant industrial sector has continued to be a major concern of most governments worldwide especially the developing countries like Ethiopia. The reasons for this are centered on the prospects that a developed industrial sector will boost manufacturing production, increase employment generation and efficiency in the sector.

Similarly, modern manufacturing processes are characterized by high technological innovations, the development of managerial and entrepreneurial talents and improvement in technical skills which normally promote productivity and better living conditions of the people. The effect of this is that productivity level will be enhanced, a sustainable level of economic

growth will be achieved with the prospect of economic diversification and increased exports. The economy will have the potential of being competitive in the global market (Olorunshola, 2002).

The Small and Medium Enterprises play a critical role in both developing and developed countries. The East Asian countries miracle was partly as a result of a vibrant SMEs subsector, which triggered the up-surge in exports and subsequent development of the industrial sector (Stiglitz 1996).

The importance of SMEs sub-sector cannot be overemphasized. The sub-sector contributes significantly in achieving various socioeconomic objectives, which include employment generation, contribution to national output and exports, fostering new entrepreneurs and providing a foundation for the industrial base of the economy (Inang and Ukpong, 1992). In low income countries with Gross National Product (GNP) per capita of between US\$100 and US\$500, SMEs account for over 60 per cent of GDP and 70 percent of total employment; in middle income countries, the SMEs produced close to 70 percent of GDP and 95 percent of total employment; and in OECD countries, SMEs constitute the majority of firms and contribute over 55 percent of GDP and 65 percent of total employment (Basu, et.al., 2005).

In attempting to conceptualize SMEs in Ethiopia, some points need to be stressed. First, there is no generally accepted definition of small or medium. Secondly, small businesses are generally quite responsive to their environment and our environment changes fast.

Changes in the environment therefore affect what constitutes a small business at a particular point in time. Thirdly, what the definition aims at is to set some limits (lower and upper) that will assist in achieving the set purpose. Such limits can be in terms of level of capitalization, sales volume and number of employees.

A clear definition may be useful in a particular national context but it may not be practical to attempt a universal definition. An attempt is made to present some definitions of SMEs to demonstrate the divergence in definition across countries.

Therefore there is no universal definition of SMEs since the sector is diverse and flexible that resists any narrow categorization. The definitions given to SME's and applied vary from country to country and also mean different things to different people, even within the same country. The definition of SME is based on five main parameters; labor capital, loan size, fixed asset and annual sales turnover. Organizations often use one criterion to define SMEs. The size limit is one of the most common definitions in developing countries. Some countries use one criterion to define this sector while others may have definitions with multiple criteria. For example South Korea defines SME on the basis of 'capital or assets', while Canada defines this term on the basis of 'number of employees' and 'gross sales or taxable income'. This also appears to be true in the case of Ethiopia. This lack of consistent definition has eventually led to be confusion and failure to distinguish between one segment and another and has significant implications on the structure of interventions and promotional support that could be provided to the section.

To see some of the definition as an example; to support and develop these businesses, the

European Union has introduced a new definition of SME valid from January 1, 2005.

SMEs are defined by three main criteria: the number of employees, annual turnover in millions of Euros and total value of assets in millions of Euros.

Together with these indicators a SMEs should also fulfill a criterion of independence which means that no other subject should participate in its basic capital or voting rights by more than 25 percent. Differences between a small and a big enterprise are as a rule defined not only by the above mentioned quantitative criteria, but also by qualitative criteria. The borderlines between small and large enterprises also depend on different conditions in individual regions and they also change with time. Basic differences between a small and medium enterprise and their interactions can be traced in several spheres. The differences are in:

- (1) Organizational and legal forms and in-house structures,
- (2) Relation between owners (entrepreneurs) and companies management,

(3) Possibilities of sales and application of marketing strategies of small and large companies

(4) Capital availability and approach to outer sources of financing. Size Number of employees  
Turn over in EUR Balance sum in EUR Medium enterprises 50 -249 Max. 50. Mil. Max.43  
mil. Small enterprises 10 -49 2 mil.-10 mil.2 mil.-10 mil.

In the developed or industrialized countries like United State of America and Canada,small  
business is defined in terms of annual turnover and the number of paid employees.

In 1987 for example, the manufacturing sector of the United State of America has as small  
scale business when the number of employees is between 20 and 49, while the medium employ  
between 50 and 499 employees in the manufacturing sector. In the UK that same year, small  
business is said to employ between 1 and 99 employees and medium scale 100 to 499  
employees in the manufacturing sector. In 1990, Japan level of employment in the small scale  
ranges between 20 and 49 and medium as 50 to 499 in the manufacturing sector (Ekpenyong,  
1997).

In the New Industrialize Countries, the definition of SMEs also varied and is mostly based on  
the number of employees and the value of assets. In Taiwan, the small scale business was  
defined as a business with less than 5 employees and the medium as the business with between  
10 and 499 employees in 1991 in the manufacturing sector. The

South Korea defined small scale enterprise in 1988 as any business that employ 5 to 19 and  
medium scale enterprises as employing between 20 and 199 without pectoral specification. In  
Bangladesh a micro firm employed less than 20, while small firm employed from 20 to 99 in  
the manufacturing sector without mentioning of medium scale enterprises in 1986. In Bolivia, a  
small scale employed 1 to 9 and medium scale 10 to 99 employees in 1992 (Hallberg, 1999).

In Ethiopia there is no clear definition of SME's. Only paid up capital is used for the  
categorization of business as micro, small and large. Small size enterprises are those enterprises  
with paid up capital of above Birr20, 000 and not exceeding Birr 500,000 excluding high tech  
constancy firms (Manufacturing enterprises) and other high tech establishments. But there is no

categorization of business above small scale enterprises as medium and large enterprises in the country. For the purpose of this paper the working definition by International Labor Organization (ILO) and United Nations Development Program (UNDP) for SMEs and large enterprises is used. The working definition by ILO and UNDP for SMEs and large enterprises indicates that: employing less than 5 employees including the owner is a micro enterprise; employing 5 to 20 employees is a small enterprise; employing 21 to 99 employees is a medium enterprise; and employing above 99 employees is a large enterprise (UNDP, 2001).

The size distribution of firms in today's developed economies is very different from that in developing ones. In the poorest countries, on average almost two thirds of workers are employed in very small (micro) enterprises that is, enterprises with less than five employees and most of the rest work for large enterprises with more than one hundred employees. Small- and medium-size firms have little presence in these economies and together employ less than 10 percent of the total workforce. By contrast, in the richest countries more than two thirds of all employees work for large enterprises, the bulk of the remainder work for SMEs, and only a very small fraction for micro enterprises (Snodgrass and Biggs 1996). Although large firms account for the lion's share of aggregate economic activity in developed countries, SMEs play a more significant role in these economies than their proportion of total employment might suggest. Not only do they make up the vast majority of firms, but they dominate many sectors of economic activity and have been an ongoing source of new products and of technological innovation more generally. One possible explanation for the relative absence of SMEs in poor economies is the difficulty of obtaining access to finance. Large firms in these countries can secure financial assistance because they have assets that can serve as collateral for loans, because their directors also serve on the boards of financial institutions, and/or because they receive special government backing. Other enterprises, however, have to rely largely on their proprietors' financial resources, which are likely to be limited, and on retained earnings, which, given the general poverty of the populations that they serve, cannot be large. Without outside sources of funds, therefore, such firms are condemned to start and remain very small.

Financial inclusion, or broad access to financial services, is identified as an absence of price and non-price barriers in the use of financial services. Improving access then means improving the degree to which financial services are available to all at a fair price.

It is easier to measure the use of financial services since data of use can be observed, but use is not always the same as access. Access essentially refers to the supply of services, whereas use is determined by demand as well as supply.

As SME's are important ingredients for stable and equitable growth in any national economy, mostly in developing countries these businesses are with many problems and their contribution is not such much as that of rich countries. One of the main problems is poor accounting practices. Therefore the researcher is also motivated to examine the problem of poor accounting practices of SME's in Wolkite.

## **2.2 Empirical evidence**

Researches will carry out on the accounting practice and the access to finance of the SME's. So this part of the paper presents the empirical evidence on the idea of the paper. The empirical evidence below is presented consecutively based on the concept of evidence.

### **2.2.1 Accounting practices**

The empirical evidence about the accounting practice of SME is organized in terms of evidence such as; record keeping, financial accounting, financial management and cost and management accounting.

Record keeping: A study involving more than 1,000 SMEs in Australia, found that majority of the respondents (85.7%) has a computer-based in-house general ledger accounting system (McMahon 1998). Larger enterprises tend to statistically use more of computer-based general ledger accounting system compared to smaller enterprises. Study examined private limited companies in the UK found that 57 per cent of the respondents had a computerized accounting system and 25 per cent had a partly computerized system suggesting moderate level of sophistication of accounting system (Collis and Jarvis 2002). In addition to their internal

accounting staff, SMEs often employ outside professionals to provide accounting advice. It has been found that the most frequently form of outsourced accounting services are for taxation purposes and preparation of accounting reports (Collis and Jarvis 2002, McMahon 1998).

Studies conducted in Nigeria and UK with a sample size of forty-five (45) questionnaires each between the UK and Nigeria and conducted two (2) Semi-structured interviews each between the UK and Nigeria. Out of the forty-five (45) questionnaires administered each in the UK and Nigeria, thirty five (35) was returned in the UK and thirty (30) returned from Nigeria. The study conducted by having the variable that was measured with the question: “Do you agree that Poor Accounting and Book Keeping practices lead to SMEs failure in your country?” and the results showed that 68 percent and 57 percent of the respondents in the UK and Nigeria respectively agreed that it influenced SMEs failure. This reflects that in both countries, the respondents quite agree that poor accounting and book-keeping practices influenced SMEs failure, Kamla-Raj (2009).

**Financial accounting related:** In Australia, there have been a large number of empirical studies conducted on SMEs such as (McMahon and Davies 1994), (McMahon 1998).

These studies investigate the types of financial reports produced by SMEs, the frequency of their preparation and their perceived usefulness for management purposes. The findings indicate that financial reports for SMEs are prepared predominantly by external accountants at annual intervals, and they normally comprise just the balance sheet and the profit and loss statement.

Other Studies were conducted in various countries to examine the usefulness of accounting reports within the context of SMEs, for examples McMahon (1998) in Australia Collis and Jarvis (2002), Gorton (1999) and Nayak and Greenfield (1994) in the UK; and Hopper et al. (1999) on SME Japanese companies. These studies found evidence that financial reports are not considered particularly useful for decision making purposes by SMEs owner-managers. These studies also found that there is limited usage of financial and management accounting reports by SMEs. In addition, it has been argued that accounting reports produced by SME's

are usually limited to a few types of simple reports comprising mainly profit and loss account and balance sheet. The studies using a postal questionnaire to small private limited companies in the UK, found that 82 per cent of the companies use monthly or quarterly management accounts, 87 per cent of the companies prepare profit and loss statement and 78 per cent prepare balance sheet (Collis and Jarvis 2002).

**Financial management:** There are a number of reasons that explain the different approach to financial management practices of small firms. Some studies showed that they are driven by the personal motivation of the owner-manager, business life cycle model; resource poverty while a dynamic view of the financial management process reveal that change may be brought about as a consequence of experiential learning of the owner managers.

A review of the literature on the financial management practices of small firms, revealed that owner-managers' personal and business goals dictate partly their approach to short-term financial management of their businesses (Collins and Jarvis, 2002). There is also theoretical justification that the business life cycle model lends support to the evolutionary approach to financial management practices of small firms (Lewis, 1983; Scott and Bruce, 1987).

Based on a literature review on financial management practices of SMEs in North America, McMahan and Holmes (1991) concluded that "the state of knowledge about financial management and the exercise of financial controls and techniques remain inadequate in small businesses." Study conducted on 200 manufacturing firms employing less than ten people in the U.K. which provides evidence that only one third of business formally monitored profits and applied any form of budgeting Nayak and Greenfield (1994).

The main factors that contribute to success or failure of small business may be categorized as internal and external factors. The external factors include financing (such as the availability of attractive financing), economic conditions, competition, government regulations, technology and environmental factors. The internal factors are managerial skills, workforce, accounting systems and financial management practices. The accounting department is generally viewed as

a service unit to support the firm's operations by providing information on costs and performance indicators.

Despite the increasing importance attached to small scale economic activities across the globe there appears to have little reported improvement in the financial management skills of small business owners (Jarvis et al, 1996).

In view of their smallness, SME need continued support in the functional areas of their businesses. The often neglected area is the accounting and finance function of the small business and yet this has not attracted much interest from the support agencies. This being so despite findings from empirical studies showed the lower intake of working capital management by small firms and the absence of accounting systems to provide owner-managers with information about their business ( Dodge and Robbins 1992, Howorth and Westhead 2003). They identified five major management problems and inventory and cost controls was the most frequently mentioned problem and was more prevalent during the late growth stage of the business. The financial related problems were grouped into three major categories, where financial planning was found to be a more pertinent problem among the respondents (42%), followed by accounting systems and record keeping, which persist during all life cycle stages except early growth. Once the firm moves along the different stage of the organizational life cycle, accounting related issues become important for the owner-manager to consider seriously. These include recording, cash flow information, inventory and cost controls. A lack of such systems affects control of the business and finding sources of capital to finance daily operations become problematic (Dodge and Robbins, 1992).

Small firms make greater use of cash-based management information and this points to the importance that owner-manager placed on controlling cash found by (Collis and Jarvis 2002). A similar finding was found by Jarvis et al. (1996)

**Cost and Management Accounting:** A study found similarities between costing systems used by SMEs and larger companies (Hopper et al. 1999). The costing systems and cost management practices used by the SMEs were mainly for product costing and budget and less

emphasis for decision making or performance evaluation. They also found that sophisticated detailed process of cost management was commonly used for engineering and quality control.

The management accounting reports studied include budgets and different types of budget variance analysis, production cost statement, cost volume profit (CVP) analysis and benchmarking report. The findings show that among the management accounting reports, majority of the respondents (92.1%) prepared budget, followed by production cost statement (82.9%), variance analysis (80.3%), CVP analysis (73.7%) and benchmarking reporting (57.9%). The findings might indicate that most of the SMEs are mainly utilizing a traditional management accounting techniques as compared to the more contemporary management techniques such as activity based costing or total quality management. Among the different types of budgets, cash budget is the most frequently prepared (93.4%), followed by sales budget (92.1%), expenses budget (86.8%) and lastly production budget (85.5%). The least prepared management accounting report is benchmarking report (CheRuhana Isa, ZakiahSaleh, NoorSharajaSapiei 2007).

To summarize others study, in spite of the importance of financial reporting, management accounting and control practices, it is unfortunate to find that these practices are often inadequate and lacking among SMEs. Except for yearly taxation returns and some form of profit and loss statements, other statements such as balance sheet, cash flow statement, fund statement, production report and variance report are infrequently used. These rather limited usage of financial and management accounting reports could be attributed to SMEs' inability to employ professional managers with functional specialization especially in the financial area due to their limited financial resources. Without adequate, effective and timely financial reports and analysis, the SMEs are losing out on the benefits from those practices such as improved monitoring of financial health and progress, improved ability to anticipate fortunes or failures, better assessments of financial risks and greater ease in financial planning and control. Most importantly, in the context of SMEs requiring extra capital to grow, regular financial reports can provide indications on their ability to produce steady cash flows and to service debt. It has been established that the use of appropriate financial reporting and management accounting

practices could be one of the determinants of company survival particularly SMEs (Gorton, 1999; McMahon & Holmes, 1991).

### **2.2.2 Access to finance of SME**

There are two sources of finance available to SME which includes; internal and external sources (Chizea, 2002). Internal sources as the dominant source of finance for most small-scale businesses. A survey conducted by the World Bank (1995) on business environment in transitional economies showed that the share of internal funding is significantly lower in advanced reforming countries as follows: Estonia 33 percent, Poland 34 percent and Lithuania 37 percent. In the United States of America, the SMEs of less than two years old, internal finance constitute 54 percent of total financing. And for most businesses, internal sources of finance constitute retained earnings for the period including provisions made for depreciation which is essentially a book transfer.

The external sources of financing constitute bank finance and other forms of institutional credit. In India, the sources of external finance include informal channels, credit unions, and commercial banks which play an equally important role in the provision of external finance asserted by (World Bank 1995). These sources are certainly not dissimilar to the complement of sources of external finance available to most businesses in Ethiopia.

External source of finance must also include public equity.

Due to their relatively small size, SMEs face constraints in borrowing. After all, only certain forms of financing are available to SMEs. What is more, the higher default risk compared to large companies results in higher charges.

The study carried out in Ethiopia indicates that access to finance is one of the crucial problems for the SME. Encouraging strides have been made in liberalizing the domestic financial sector; still it is a bottleneck for the rapid growth and development of the sector.

In the study, 79% of MSMEs stated that getting credit finance from formal financial institutions is a key problem (Wole 2004). In 2001, a study identified poor access to finance as

the most critical constraint on SME's in Nigeria. In fact, 50 percent of the surveyed enterprises received external finance while 79 percent indicated lack of financial resources as a major constraint (Guardian, 2001).

A similar study was made in Ghana which focuses on addressing the issue by ascertaining the various factors, which influence an entrepreneur's access to finance.

These factors include location, size, initial capital, and level of debt, exports and socioeconomic factors. The SME survey in Ghana revealed that there was a 42 percent chance of an SME loan application to a formal financial institution being granted.

However, there were variations in the success rate, which runs across the urban and rural areas. Thus, location is an important determinant of firm's access to credit. *Ceteris paribus*, urban enterprises record a higher success rate than rural enterprises (Kimuyu and Omiti, 2000).

Firms with some level of debt are often seen as credit worthy and stand an improved chance of obtaining further credit. Credit risk and inflation risk are two major important variables affecting small business credit hence; lenders prefer granting credit to old firms who have established good credit records (Collier and Pattillo, 2000). Besides credit risk, inflation adds to the cost of credit. In the world over, small businesses face more constraints at start up developmental phases than when established. In Africa, for example, the failure rate of SMEs is 85% out of every 100 companies due to lack of skills and access to capital (Fadahunsi, 1997).

In the traditional approach to SME development, governments have provided credit to

SMEs through first-tier development banks, second-tier credit facilities channeled through banks and other financial institutions, and portfolio requirements on banks, often supplemented by credit guarantee schemes. Subsidized interest rates and guarantees were common in the past and continue to be used in many countries. In part, this reflects a presumption that the high cost of credit is the main constraint facing SMEs, even though there is evidence that SMEs care more about access to credit than its cost (Sakai and Takada, 2000). The traditional approach of

subsidized credit also may have been a reflection of the importance of state owned banks in developing countries financial markets.

In Ghana SMEs rely primarily on personal savings of owners, business profits, family members or friends for their financial needs argued that (Okraaku and Croffie 1997). They have little or no access to external credit. The effect of this is inadequate fixed capital as well as working capital. The consequences of these are very slow growth rate and frequent failures among small businesses. At the regulation level, the problems identified are high interest rates charged by banks thus making bank borrowing very expensive.

### **2.3 Research gap**

As previously mentioned, SMEs are a significant component of developing country economy like Ethiopia and there is a lack of empirical evidence concerning their accounting practice and its effect in raising credit from banks and making investments of SMEs in Wolkite. Therefore, this study examines SMEs accounting practice and its effect on accessing finance in Wolkite to provide empirical evidence of this gap.

## CHAPTER THREE

### 3 DATA AND 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 (Creswell 2002). The nature of the survey is the cross-sectional, because it is possible to obtain the desired information at one time.

#### 3.1 Sampling

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 will adjust to increase the accuracy of the survey across activities and size classes.

The reason is that in Stratified random sampling specific characteristics of individuals (e.g. both females and males) are represented in the sample and the sample reflects the true proportion of individuals with certain characteristics of the population (Jfowler, 1988). The sample sizes for each economic activity were selected to ensure sufficient representativeness across the three major activities: retail, wholesale and services. The purpose of stratifying firms in this form is to draw representative sample from each stratum.

#### 3.2 Instrument and data collection

Primary data was used for the study objective. The primary data for this study was gathered by distributing structured questionnaire for the owner or management of the enterprises and other separate close ended question will develop for the face to face interview of the banks

management or other concerned body questions related to precondition for the provision of loans to SME's. Both close ended questions were developed by the researcher. The reason for selecting face to face interview is impossible to apply other means of interviewing in our country because it very costly interviewing through telephone and additionally face to face interview helps to make clarification about the question to interviewee.

### **3.3 Theoretical framework**

In this section, the study considers the theoretical background of modeling the variables of our interest depending on the explanatory variables that determine them. In this regard, as our variables of interests are accounting practices and access to finance, the theoretical framework of modeling them is dealt with as follows.

#### **3.3.1 Accounting practices**

A number of variables are expected to give an insight into the sample firms approach to accounting practices, in particular the accounting practice in place to provide financial information. These include; age of the business, capital of the firm and manager's education level. Accounting function of an organization may be regarded as a service of accounting department whereby the department capture transactions, process same and formulate report to the user to facilitate the decision making process. Measurement of accounting practices: Simplified financial reporting standards should be adopted or set for SME. Entities, which do not fall into the definition of public interest entities, will fall into the SME category. There is international acceptance that SME require simplified financial reporting standards fitting their reduced size and narrow stakeholder base. The International Accounting Standards Board is in the process of setting simplified accounting standards, which can be adopted or adapted for the small and medium enterprises in Ethiopia.

According international accounting standard board SME at least should report the following financial statements (IFRS 2005):

Balance sheet: Each enterprise should determine, based on the nature of its operations, whether or not to present current and non-current assets and current and non-current liabilities as separate classifications on the face of the balance sheet.

At a minimum, the face of the balance sheet should include line items presenting the following amounts:

- (a) Property, plant and equipment;
- (b) Intangible assets;
- (c) Financial assets (excluding amounts shown under (e) and (f));
- (d) Inventories;
- (e) Trade and other receivables;
- (f) Cash and cash equivalents;
- (g) Trade and other payables;
- (h) Tax liabilities and assets;
- (i) Provisions;
- (j) Non-current interest-bearing liabilities; and
- (k) Issued capital and reserves.

Additional line items, headings and subtotals should be presented on the face of the balance sheet when such presentation is necessary to present fairly the enterprise's financial position.

Income statement: At a minimum, the face of the income statement should include line items that present the following amounts:

- (a) Revenue;

- (b) The results of operating activities
- (c) Finance costs
- (d) Tax expense;
- (e) Net profit or loss for the period.

Additional line items, headings and subtotals should be presented on the face of the income statement when such presentation is necessary to present fairly the enterprise's financial performance.

The common financial reports generated from the accounting systems of SMEs are the income statement and balance sheet. The income statement conveys the company's revenue, expense, and net income (or net loss) for a specific time period, which is very crucial for decision-makers. The balance sheet supplies information which helps users assess a company's ability to increase owners/managers wealth and remaining solvent.

The standard financial statements of SMEs do not include cash flow statement (Arnold et al 1984; DeThomas&Fredenberger 1985) and SMEs tend to limit preparation of financial reports to the statutory requirement (DeThomas&Fredenberger 1985).

Given the definition, measurement and detail concept on accounting practice, there is a need to consider variables that affect the accounting practice of a firm before developing the empirical model for the variable. As stated in different literatures, accounting practice is affected among others, by variables such as capital of the firm, educational level of the managers, and age of the firm.

Age of the firm and accounting practice: Once the firm moves along the different stage of the organizational life cycle, accounting related issues become important for the owner-manager to consider seriously. These include recording, cash flow information, inventory and cost controls. A lack of such systems affects control of the business and finding sources of capital to finance daily operations become problematic (Dodge and Robbins, 1992).

A review of the literature on the financial management practices of small firms, revealed that owner-managers' personal and business goals dictate partly their approach to short-term financial management of their businesses (Deakins et al., 2001; Jarvis et al., 1996; Collins and Jarvis, 2002).

Firm Capital and accounting practice: Most of the SMEs have difficulty in maintaining accounting practice because of a limited capital they have for maintaining or employing professional person maintaining this task.

Except for yearly taxation returns and some form of profit and loss statements, other statements such as balance sheet, cash flow statement, fund statement, production report and variance report are infrequently used. These rather limited usage of financial and management accounting reports could be attributed to SMEs' inability to employ professional managers with functional specialization especially in the financial area due to their limited financial resources (Gorton, 1999; McMahon & Holmes, 1991).

Manager's education and accounting practice: The low intake of accounting as one of the key contingent factors in an SME adopting new accounting procedures may be related to the academic background of the managers.

There is a positive correlation between structure of accounting department and level of education and training of manager's reported by (Collis and Jarvis 2002). They found that a large proportion of companies employ bookkeepers and credit controllers, which point to the importance attached on record keeping and controlling cash and the level of debts.

Couple with the high level of education and training, that the "small companies have the financial expertise available internally to aid the generation and analysis of financial information" concluded by (Collis and Jarvis 2002, p.104).

### **3.4 Data Analysis Method**

The collected data was processed, analyzed and interpreted to report the result of researcher finding of the selected firm. The data analysis begins by editing and classifying the collected

data in more meaningful and relevant information to the study by attached documents (if any) as it is appropriate in conducting the study. Data editing means the process of examining collected data identify errors and omissions. As to data classification, the gathered data are arranging and grouped in to similar categories and generalize the data in order to facilitate the study. The interpreted data was summarized and concluded in to meaningful way that can be understood by any concerned body. Finally, narrative sentences used to present the study report and where necessary descriptive way of data analysis by comparing actual finding with theory in conducted the study.

## CHAPTER FOUR

### RESULTS AND DISCUSSIONS OF DESCRIPTIVE ANALYSIS

#### 4.1 Descriptive statistics

The pattern of distribution and retrievals of questionnaire, in accordance with the different business classes, i.e. small and medium enterprises, provides very useful insights into the spatial concentrations of such businesses in Wolkite.

Accordingly, an attempt is made here, to summarize these response patterns as revealed by the results of the survey. It should however be appreciated, right from the on-set, that what governed the proportional distributed between the small and medium scale enterprises was the degree of spread across the town .

A total of 63 questionnaires were distributed across the various SME in Wolkite, out of which the whole 63 were completed and retrieved, representing 100% retrieval (response) rate. Out of the 63 questionnaires administered 42 and 21 were distributed to Small and Medium scale enterprises respectively. The number of questionnaires retrieved from small and medium scale enterprises are 42 and 21 respectively. This represents a retrieval rate of 100% for both small and medium scale enterprises.

#### 4.1.1 Distribution of the SME's by the legal status and size

The legal status of the firms was analysed in terms of whether they are sole proprietorships, partnerships, private limited company. The size of the business is also analysed as small and medium sized enterprises. The study result is depicted below on the legal status and size of SME Wolkite.

*0:1Table 4-1 Distribution of the SME's by the legal status and size*

Legal status	Business by size	Number	Percentage
Sole proprietor	Small	16	38
	Medium	4	19
Partnership	Small	6	14
	Medium	3	14
Private Limited Company	Small	20	48
	Medium	14	67

The result revealed that sole proprietorship represent 32 percent of the sample SME, out of which 38 percent is small scale business and medium scale enterprise claim 19. Private limited company takes the lion share of sample SME that is 54 percent of sample firm is under this legal status, from this it has 48 percent of sample small scale enterprise and 67 percent of sample medium enterprise.

Partnerships, according to survey reports, are less prominent in the town. This category of legal status represents only 14 percent of all the sample firms. This firm has 14 percent of sample small scale enterprise and 14 percent of sample medium scale enterprise.

#### 4.1.2 Age of the SME

It is of interest to test if the business life cycle model has an impact on the sample firms accounting systems. A similar finding was reported by Dodge and Robbins (1992) and Kesseven Padachi (2008). The survey result is depicted in the following table.

*0:2Table 4-2 Age of the SME*

Year of operation	Business by type	Number	Percentage
1 to 7 years	Service	2	10.5
	Retail	4	13
	Wholesale	1	7.7
Above 7 years to 11 Years	Service	4	21
	Retail	8	26
	Wholesale	2	15
Above 11 years to 15	Service	7	37
	Retail	7	22.6
	Wholesale	3	23
More than 15 years	Service	6	31.5
	Retail	12	39
	Wholesale	7	54

Source: Own survey of SME

As shown in the above table the survey result has indicated that the years of establishment of the enterprises in the town ranged from one to more than fifteen years. There is an indication that most of the firms were established before fifteen years ago as shown by the survey results. In the Wholesale business 54 percent of the enterprises were established in the last fifteen years, retail recorded 39 percent and service accounted for 31 percent. Business lines that fall under the above 11 to 15 year range accounted for 37 percent of service business, 23 percent of retail business and 23 percent of wholesale business. Similarly business lines that fall under the above 7 to 11 year range accounted for 21 percent service business, 26 percent retail business and 15 percent wholesale business.

However, the distribution of enterprises that were established between 1 to 7 years ago has relatively fewer. Apart from service business which claimed 11 percent, retail business claimed 13 percent and wholesale business accounted for 8 percent.

An analysis of the distribution based on year of establishment by major lines of business under the different business classes shows that the oldest firms in the town are mostly found under the wholesale and retail business and these were established more than ten years ago. Very few enterprises indicated that they were established between 1 to 7 years ago. tabulation reveals that most of firms in the age of above 11 to 15 years (45%) and more than 15 years (52%) keep formal accounts and pay more attention to accounting routines. It may thus conclude that the accounting tasks are seen more as a necessity and not as a normal function among the small to medium sized in Wolkite SME. Firms below 1 to 7 years of age are in its establishment stage and may thus have very basic systems of recording.

### 4.1.3 Management of the SME

SMEs can be managed by different individuals such as; by owners, by employee/salary manager or some other individuals. The following table 4-3 displays the manager of sample SME.

*0:3Table 4-3 Management of the SME*

Manager of the SME	Number	Percentage
Owner	38	60
Employee manager/salary	18	29
Someone else	7	11

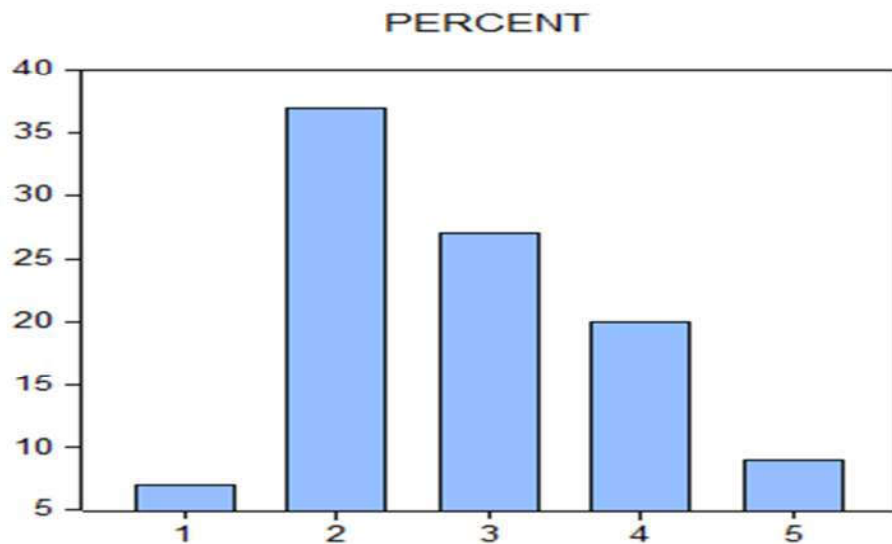
Source: Own survey of SME

Table 4-3 displays the sampled firms' management structure under three categories; namely owner, employee manager (salary manager) and others (someone else)

The largest proportion of sampled SME's 60 percent was owner-managed, 29 percent were salary-managed firms and firms managed by others individual(s) is/are accounted for 11 percent of the total sample. It included from the above facts the managers' educational level and accounting skills are the determinant for the firms accounting practice.

#### 4.1.4 Level of Education of the SME managers

The low intake of accounting as one of the key contingent factors in an SME adopting new accounting procedures may be related to the background and attitude of the manager. They may be well versed with the product/service that their businesses deal with. However, they may not be trained or proficient in business management skills, especially at the early stage of the business life cycle. The academic background of the SME manager is as follows:-



*Figure 1 4.1: Level of Education of the SME managers*

Source: Own computation

Note: the numbers on the horizontal axis: 1, 2, 3, 4, and 5 are illiterate, less than grade 9, grade 9 to 12 complete, TVT or diploma and BA/ BSc and above, respectively. The vertical axis represents percentage of educational level.

The study result reveals that there is only 7 percent manager within the sample SME with no formal education, 37 percent had obtained less than grade nine educations, 27 percent had obtained at grade nine to twelve complete education, 20 percent had obtained TVET/diploma level of education and 9 percent were university graduates with BA/BSC degree and above. More over 18 percent have professional qualifications in Accounting, Marketing, Management and economics. The relatively high literacy rate within management of SMEs in the town may have helped these firms to maintain an accounting record and in getting access to finance. The study result revealed that most of firms with manager’s academic background of accounting, marketing, management and economics maintain formal accounting practice and have access to finance than other firms.

#### **4.1.5 The role of the manager in SME firms**

The role of the manager is the main determinant for the firm’s success. The main role of the manager is categorized as; overall responsibility, administrative and finance and some other responsibility. The survey report is depicted in the table 4-5 below.

*0:4Table 4-4 the role of the manager in SME firms.*

Main roles	Number	Percentage
Overall responsibility	42	66.7
Administrative and finance	21	33.3
Some other responsibility	-	-

Source: Own survey of SME

The survey has indicated that the largest proportion of the SME managers' main role is the overall responsibility of the firms. The study result shows that 66.7 percent of sampled SME managers' role is overall responsibility. Where managers responsible only in administrative and finance is accounted for 33.3 percent of the sampled SME. Thus, in the majority of the cases, the manager oversees all the operational aspects of the enterprise and may thus have no time to perform even some of the basic accounting routines. In addition to this a significant number of managers are also engaged in administrative and finance, which indicates that manager education, is the determinant variable for the firm accounting practice.

#### **4.1.6 Accounting practice of SME**

Accounting may be the key to small business success. Wichmann (1983) reported the results of an analysis of Small Business Institute (SBI) cases, which were grouped into seventeen problem areas. Accounting was found to be the most frequent problem, and the number one in this category was recordkeeping (60%). The study result is depicted below in the table4-5.

*0:5Table 4-5 Accounting practice of SME*

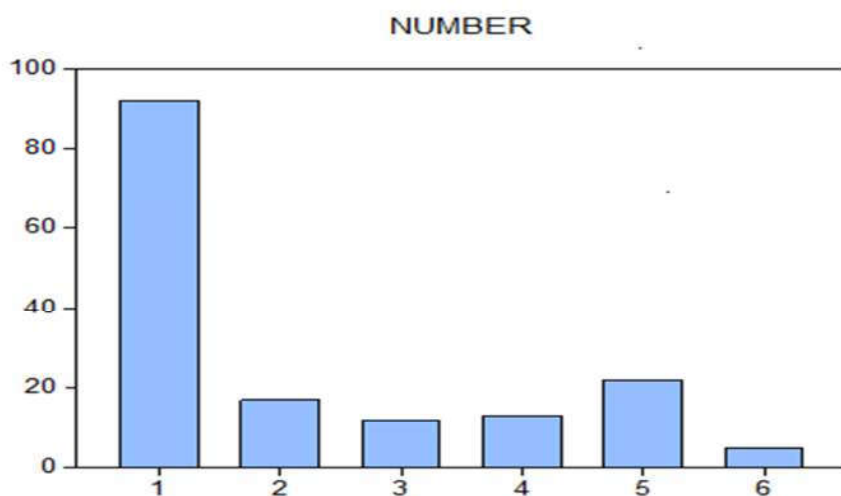
Accounting system	Number	Percent
Do not maintain any accounting		
Maintain minimum accounting	37	59
Maintain formal accounting practice	26	41

Source: Own Survey of SME

The survey result indicates that most of the sampled SME is not maintaining a formal accounting. That is firms that maintain only minimum records is accounted for 59 percent of the sampled SME's and firms maintain formal accounting is accounted for 41 percent of the sample. Thus in the majority of the case the failure of firms in getting access to finance may be because of not maintaining a formal accounting.

#### 4.1.7 Source of financing SME at start-up and expansion of the business

There are a lot of sources available for the financing of SMEs sector. This includes among others own savings, friends/relative, iqub, microfinance, Banks, and informal money lenders. These sources of financing SMEs are available in Ethiopia but having access to some of the sources is a major constraint and has hampered the growth of the SME sector. The survey report on the sources of finance to SMEs is presented in figure 4.2 below.



*Figure 2 4.2: Source of financing SME at start-up and expansion of the business*

Source: own computation

Note: the numbers on the horizontal axis: 1, 2, 3, 4, 5 and 6 are own saving, friend/ relatives, iqub, microfinance, bank and informal money lenders, respectively. The vertical axis represents percentage of educational level.

The above table displays an SME source of financing for the startup and expansion of the business. The study result shows that a large proportion (82%) of respondents started and expand business with their own money, this followed by money obtained from relatives and(or) friends (15%), iqub schemes (social capital) claim 11%, microfinance institutions (11.6 %), banks (19.6%), and informal money lenders (4.5%). This indicates

Most of the SMEs do not have access to the credit giving by financial institutions. Although money rose from finance institution is not a major source of start-up capital and expansion of business, its contribution is quite significant.

#### 4.1.8 Constraints in accessing to credit

There are a lot of constraints for getting an access to credit among SMEs sector. This includes among others accounting practice, Collateral, size of the business, initial capital, total debt and others. The survey report is presented below on the constraint to get access credit among SMEs sector in Wolkite.

*0:6Table 4-6 Constraints in accessing to credit (Total firms 50)*

Constraints	Number	Percent
Accounting practice	18	36
Collateral	23	46
Age	11	22
Others	15	30

Source: Own survey of SME

The survey result indicates that SME's in wolkite are more credit constrained because of the different factors. The study observed a positive relationship of access to finance with the factors such as; accounting practice, collateral, age of the firm and other factors. This is 36 percent of sample SME's lack access to finance because of poor(minimum) accounting

practice, collateral claim 46 percent, age of the firm 22 percent, and other factors claim 30 percent of the sample. This indicates that accounting practice of the SME is significantly affects access to credit of the firm.

#### 4.1.9 Frequency of accessing to credit

The frequency of accessing to credit of a firm each year certainly indicates the access to credit of the firm. The table 4-9 below shows the frequency of SME accessing to bank credit in the year 2020.

*0:7Table4-7 Frequency of accessing to credit*

Frequency	Number	Percent
No access in a y	9	41
Only one time	11	50
Two times	2	9

Source: survey of SME 2020

As revealed in the above table the frequency of accessing to credit range from less than one time in a year to two times a year. From sample SME having access to credit 41 percent have no access to credit in a year, 50 percent have one time access to credit in a year and 9 percent have two time access to credit in a year. Therefore the above result may indicates that most of firms have only one time access to finance in a year and only a few firms have two times access to finance in a year.

A significant number of firm have no access to finance in year this is because of the fact that they were borrowed long term loan in the previous year.

#### 4.1.10 Accounting tasks of SME

Accounting may be the key to small business success. Wichmann (1983) reported the results of an analysis of Small Business Institute (SBI) cases, which were grouped into seventeen problem areas. Accounting was found to be the most frequent problem, and the number one.

*0:8Table 4-8 Accounting tasks of SME*

<b>Practices/accounting tasks</b>	<b>Number</b>	<b>Percent</b>
Keeping records	<b>63</b>	<b>100</b>
Payroll	<b>63</b>	<b>100</b>
Taxation/ VAT	<b>52</b>	<b>82.5</b>
Bank statement	<b>13</b>	<b>20.6</b>
Income statement	<b>20</b>	<b>32</b>
balance sheet	<b>15</b>	<b>24</b>
Periodic management accounts	<b>33</b>	<b>52</b>
Inventory and cost controls	<b>30</b>	<b>47.6</b>
Break even analysis		
Cash budget	<b>4</b>	<b>6.35</b>
Sales budget	<b>5</b>	<b>8</b>
Expenses budget	<b>5</b>	<b>8</b>
Budget variance analysis		
Ratio analysis		
Working capital management	<b>9</b>	<b>14</b>

Source: Own survey of SME

The survey result indicates that most of the sampled SME maintain only a limited (minimum) accounting practice. Accounting practice maintained by most of the firm is as follows; 100 percent of the sample firm prepare payroll and maintain a minimum records.

From the sample SME 82.5 percent is the VAT register and maintain a VAT records. 20.6 percent, 32percent, 24percent, 52percent, 14 percent and 47.6 percent of sample firm maintain bank statement, income statement, balance sheet, periodic management account, working capital management and inventory and cost control respectively. Only a few number of the maintain cash budget, sales budget and expense budget. There is no firm which prepares break even analysis, budget variance analysis and ratio analysis account. Therefore this study evidence the poor accounting practice of most of the SME in the town.

#### **4.1.11 General Profile of Surveyed Banks**

As mentioned earlier in the paper, the study interviewed 6 banks to ascertain the nature of their operations particularly the credit service they offer to SME in Ethiopia. The institutions visited include the commercial bank of Ethiopia, Nib International Bank, Dashen Bank, Abysinia Bank of Ethiopia, Oromia International bank and Wegagen bank. Government owned Banks accounted for 16.67 percent of the sample and the rest is private owned banks.

Banks providing financial services to SMEs were asked to rank their credit portfolio from 1 to 3 (1-very importantly, 2-importantly, 3-less importantly). The table4-11 below summarizes the response of sampled banks.

*0:9Table 4-9 General Profile of Surveyed Banks*

Bank requirement	Rank					
	Very importantly(1)		Importantly (2)		Less importantly(3)	
	Number	Percent	Number	Percent	Number	Percent
Financial information	4	67	2	33	–	–
Collateral	3	50	3	50	–	–
Capital	4	67	2	33	–	–
Age of the firm	1	16.7	4	67	1	16.7

Source: own survey of banks

Six selected Banks providing financial services responded to this question and their responses are as follows: 100 percent of respondents gave a rank of 1 and 2 for the requirement of financial information. This indicates that SME serving banks attach very importance and importance to the requirement of financial information provision in their credit portfolio. Banks require maintaining formal accounting, but sometimes if the other requirement like collateral is exist the financial accounting requirement is maintaining only minimum records for example commercial bank of Ethiopia. From the financial information, information commonly required by banks are; income statement, balance sheet and a relatively few banks require statement of cash flow. In the case of collateral,

100 percent of the institutions gave a rank of 1 to 2. This is a possible indication that collateral based financing ranks high among the credit portfolio of these banks.

Age of the firm is also seen as a requirement by the most of the banks. The study result reveals that 83.7 percent of sample banks require age of the firm very importantly and importantly. Only 16.7 percent of sample banks see age of the firm less importantly. Because of the above reason and others banks are reluctant in lending loan SMEs. Similar finding were made that the formal financial institutions are reluctant to avail credit facilities the sector. Formal financial institutions such as commercial banks are reluctant to lend small amounts of money to small businesses because the cost of administering the loan exceeds the benefits accrued to them (Eshetu Bekele and Mammo Muchie 2009).

## CHAPTER FIVE

### CONCLUSIONS AND RECOMMENDATIONS

#### 5.1 Conclusion

SMEs are an important ingredient for stable and equitable growth in any national economy. Ethiopia takes the development and expansion of SME's as the main way to solve many of the social problems. At present in Wolkite various reforms and development activities are being carried out. One of these is the promotion and development of SME's in the town.

Considering the enormous potentials of the SMEs sector, and despite the acknowledgement of its immense contribution to sustainable economic development, its performance still falls below expectation in many developing countries. SMEs frequently lack access to institutional credit, causing them to encounter high financing costs and high failure rates. Similarly in Wolkite SMEs continue to exist with many problems among others are; inability to maintain accounting practice and lack of access to credit. SMEs lack of access to credit and high interest rates charges are partially the result of incomplete (or no) accounting records, and the inefficient use of accounting information. Poor record keeping and accounting information make it difficult for financial institutions to evaluate potential risks and returns, making them unwilling to lend to SMEs. Age of the firm and collateral are also the other determinant factor of the access to finance.

Incomplete (or no) accounting practice of SMEs is the result of limited capital they have, age of the firm and manager level of education. These are the determinant of the accounting practice of the SME. All the above problems hinder SME not to continue to expand and function as expected in the country.

## **5.2 Recommendations**

Based on the findings of the study, the following recommendations can be drawn.

There is the need for clear national development objectives to meet the needs of the SMEs sector. Sound policies and regulations should be developed since this sector is the missed sector in the country particularly medium sized business.

Since there is international acceptance that SME require simplified financial reporting standards fitting their reduced size and narrow stakeholder base, the government needs to adopt Simplified financial reporting standards set for SME.

Government should accelerate the development of market for financial services suited to the special characteristics of SMEs by promoting product innovation and building institutional capacity. Improving SMEs access to credits requires an increase in the number of financial institutions that find lending to SMEs to be profitable and therefore sustainable.

Easy accessibility to credit through specialized or development oriented banking or financing institutions. Funds being made available through these sources should be given at preferential interest rate.

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# APPENDICES

## APPENDIX 1: Questionnaires

### WOLKITE UNIVERSITY

#### COLLEGES OF BUSINESS AND ECONOMICS

#### DEPARTMENT OF ACCOUNTING AND FINANCE

This questionnaire on the subject "Accounting practice of small and medium sized enterprises and its effect on access to finance in Wolkite " has been designed purposely to source information on accounting practice of the firms and credit delivery to start-up and/or expand SMEs businesses in Wolkite through the external sources of finance. The information supplied will be treated in utmost confidentiality and use mainly for the purpose in which the study is intended (Only for academic purpose).

Your honest and objective answers to the following questions will be highly appreciated and acknowledge. This is the question to be filled by the owner or the manager of the business. Please answer the following question accordingly; by choosing best alternative for multiple choices and for the box provided put a tick mark (√) in the appropriate box provided for the answers. You may have more than one choice depending on some questions.

Name of your business (optional)

1. What is the type of your business?

a) Service      b) wholesaler      c) Retailer

2. How old is your business?

a) 1 to 7 years      b) Above 7 years to 11 years

c) Above 11 years to 15 years      d) More than 15 years

3. What is the number of your employees?

a) five to twenty      b) twenty one to ninety nine

4. Who is the manager of your business?



Lack of access            No need of credit

12. Which of the following factors may hinder you in accessing credit?

Collateral                      Accounting practice

Age of the firm

13. Is there is (are) any other thing that may hinder you not to get access to finance?

Yes                                  No

14. What was the source of finance for the startup of your business?

Own saving            Friends/relatives            Banks            Micro finance

Iqub                      Informal money lenders

Please put the check mark in the box provided for the question 15-19.

15. Which of the following accounting do you practice in the business?

Keeping records            payroll            taxation/ VAT            Bank statement

17. Which of the following cost and management accounting do you practice?

Periodic management accounts            Inventory and cost controls

Break even analysis

18. From the budgetary accounting which of the following do you prepare?

Cash budget                      Sales budget

Budget variance analysis            Expenses budget

WOLKITE UNIVERSITY

COLLEGES OF BUSINESS AND ECONOMICS

DEPARTMENT OF ACCOUNTING AND FINANCE

This questionnaire on the subject "Accounting practice of small and medium sized enterprises and its effect on access to finance in Wolkite " has been designed purposely to source information on accounting practice and credit use to start-up and/or expand SMEs businesses in Wolkite through the external sources of finance. The information supplied will be treated in utmost confidentiality and use mainly for the purpose in which the study is intended (Only for academic purpose).

Your honest and objective answers to the following questions will be highly appreciated and acknowledge. This is the question to be filled by the concerned body in the banks. Please answer the following question accordingly; by choosing best alternative for multiple choices and for the box provided put a tick mark (✓) in the appropriate box provided for the answers. You may have more than one choice depending on some questions.

For this study Small and medium sized enterprise (SME) is business which has employee 5 to 99.

Name of the bank (optional)

1. Do you have customers from small and medium sized enterprise?

Yes                      No

2. Do you agree that Accounting practices of SME lead to influence access to finance?

Yes                      No

3. Would you require provision of financial information for providing the loan to small and medium sized enterprise?

Yes                      No

If yes how do you rank it?



10. Would you have other criteria for the provision of loan to SME?

No

Yes