

Professional Advice and its Possible Effect on Small and Medium-sized Enterprises' Access to External Debt Finance in Australia

Mariya Yesseleva

Unit Coordinator at Top Education Institute, Australia

Email: mariya.yesseleva@top.edu.au

Abstract

Purpose: This research study presents a literature review and descriptive statistics analysis on sources of professional advice and their possible effect on small- and medium-sized enterprises' access to external debt finance in Australia.

Design/Methodology/Approach: In total eight sources of professional advice were analysed in relation to SMEs access to external debt finance in Australia. Cross tabulation method was applied to study a possible association between access to external debt finance and sources of professional advice.

Findings: This research study relied on the data obtained from the Australian Bureau of Statistics. Findings indicate that majority of SME owner-managers tend to rely to a great extent on the advice received from accountants and financial advisors/banks; and SMEs reliance on advice received from government organisations appears to be limited.

Originality/value: It has been documented in earlier research studies that professional advice may have an effect on a number of SME's business operations. However, their impact on access to external debt finance has received limited attention.

Keyword: Small Enterprise, SME, External Debt, Professional Advice

Note: Australian Bureau of Statistics (ABS) is the source of the data in this research study. However, the results or views expressed are those of the author, and not necessarily those of the ABS.

Introduction

Previous research studies (Carey, 2008; Cassar & Holmes, 2003; Lee & McGuiggan, 2008; Shailer, 1999) have investigated the effect of advisory service on a number of SMEs' aspects, such as access to external finance, performance, financial decision-making, financial structures and growth. It has been documented in previous studies (Carey, 2008; Shailer, 1999; Shanmugam, 1988) that accountants played a vital advisory role for the SME sector. Previous research studies overlooked important professional advice services to SMEs offered for instance, by Industry Association/Chamber of Commerce, the Australian Taxation Office, accountants, financial advisors or banks, solicitors and business management consultants. At this stage, no study has emerged that collectively analysed a wide range of professional advice sources for SMEs and the effect they might have on access to external finance in Australia.

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This research study aims to make a contribution to the existing academic literature and expand previous studies that to some extent analysed advisory services and their impact on SMEs' access to external debt finance. This research study results will benefit not only policy makers dealing with SMEs but also SME owner-managers applying for external debt financing.

Literature Review

Various characteristics are incorporated in SME definitions across the globe. Criteria to define a small enterprise may include turnover, assets, employment numbers and management characteristics (Lee & McGuigan, 2008). Generally, qualitative and/or quantitative characteristics are being incorporated in SME definitions across the globe. The definitions of the SME sector in the Asia-Pacific Economic Cooperation (APEC) countries clearly demonstrate both types of definitions, and tend to include number of employees, type of industry, and maximum levels of capital, assets, sales and revenue.

Table 1: SME Definition Criteria in APEC Countries

Country	Number of Employees	Sales/ Revenue	Assets	Capital/ Investment	Sector
Australia	X				
Brunei Darussalam	X				
Canada	X	X			X
Chile	X	X			
China	X	X	X		X
Hong Kong, China	X				X
Indonesia	X	X	X		
Japan	X			X	X
Korea	X	X		X	X
Malaysia	X	X			
Mexico	X				X
New Zealand	X				
Papua New Guinea				X	
Peru	X	X			
Philippines	X		X		
Russia	X	X			
Singapore	X		X		X
Chinese Taipei	X	X		X	X
Thailand	X		X		X
United States	X	X			X
Vietnam	X			X	

Source: APEC (2010, p. 3)

According to the World Bank (2010), the most accepted cut-off points for the maximum number of employees concentrate around 50, 100, and a large portion of economies set 250 employees as the maximum cut-off point. Further, it was emphasised that number of employees and sales volume may be regarded as one of the most precise characteristics that define SMEs, but these details are not always available from lenders. The World Bank (2010) also made a recommendation to banks/financial institutions to collect and maintain information on sale volumes and number of employees, as this will assist with more accurate monitoring of SME lending.

The aforementioned characteristics, which are adopted in SME definitions around the globe, are all powerful and coherent in their own sense. These characteristics included number of employees, sales/revenue, assets, annual turnover, balance sheet total, legal type, capital/investment and industry sector (APEC, 2010). This research study follows the Australian Bureau of Statistics' (ABS) definition of SME that incorporates one of the most common characteristics in SME definitions around the globe—number of employees. The ABS's (2009) definition of small and medium enterprises, includes:

- *“non-employing businesses—sole proprietorships and partnerships without employees;*
- *micro businesses—businesses employing less than 5 people, including non-employing businesses;*
- *other small businesses—businesses employing 5 or more people, but less than 20 people;*
- *medium businesses—businesses employing 20 or more people, but less than 200 people”.*

Source: www.abs.gov.au

However, the ABS definition is complemented by specific management/organisational characteristics attributable to SMEs. These characteristics include independent ownership, and close control and principal decision-making by the owner-manager. In addition, this thesis includes additional information related to SME's management/organisation, performance and financing issues in Australia.

Professional Advice

According to Cassar and Holmes (2003), when it comes to SMEs' financial decision-making and structures, it may be a direct function of the constrained management skills and knowledge of small business owners, who normally operate without day-to-day access to appropriate professional advice. Based on a research study conducted by Lee and McGuiggan (2008), the larger the business, the greater the preference for using consultants to gain financial skills. Further, the study found that SME owner-managers lacked critical financial management skills and the knowledge to efficiently and effectively manage and grow their businesses.

Previous research studies examined the effect of accounting advice on SMEs operations and financing (Bisman, 2007; Carey, 2008; Dyt & Halabi, 2007). The lack of accounting reports by smaller enterprises provide implications for the role of the accountants (Dyt & Halabi, 2007). As noted by Carey (2008), external accountants had long provided compliance and monitoring services to the SME sector. This was supported by Bisman (2007, p. 1), as *“accountants are generally viewed as the most important source of external advice by small business entrepreneurs.”*

Indication that businesses have used the services of a public accountant who assisted with loan applications may provide credibility signals to the bank/financial institution (Shailer, 1999). The same study also emphasised that the extent to which public accountants were used in preparing information for loan applications was not thoroughly researched.

“Bank manager's criticisms of professional accountants, when dealing with SMEs, can be summarised as follows:

- *Accountants usually do not attempt to conduct a detailed examination and interpretation of the accounts for their clients, and ...*

- *Accountants appeared to have little conception of the importance of time when preparing accounts” (Shanmugam, 1988, p. 91).*

The above quote shows the significant role that accountants may play in preparing financial information, which may contribute to easy access to external debt finance. It also highlights a particular emphasis that bank managers place on financial reporting when dealing with loan applications. This was also acknowledged by McMahon (1998) p.150, who stated that *“lenders may ask for a great deal of financial information because they do not bear the cost of its preparation ... or because they are excessively conservative.”*

According to Coleman and Carsky (1999), credit providers expect and demand financial reports, statements and financial forecasts. There are no legislative limitations in the SME environment on auditor-provided business advisory services (Carey, 2008). The research study by Carey (2008) investigated whether an association existed between external auditing and SME performance. It was noted that one of the important benefits of an audit was that it enhanced the reliability of the financial information used by external capital providers for monitoring purposes. This was supported by Coleman and Carsky (1999), as small business owners tend to have incomplete information about the financial condition of the business.

One potential economic benefit, proposed by Carey (2008), was that SMEs could gain from an external audit by receiving a lower interest rate on its major borrowings. The major finding in the same research study was that the interest rate paid by an SME on its major borrowings was negatively associated with an external audit, was not supported. Carey (2008) also emphasized that Australian SMEs that voluntarily provide audited financial statements to their lenders did not pay a lower interest rate, and the interest rate effect did not decrease with business size.

A research study conducted by Scott and Irwin (2007) studied the relationship between the use of external advice and access to finance for SMEs in the U.K. The results of the analysis suggested that there was a correlation between the provision of external advice and SMEs’ ability to get access to bank finance. The study particularly concentrated on the following SME characteristics: gender, ethnic and educational differences. It was also noted that previous research studies, that investigated different types of external advice used by SMEs, did not attempt to link types of advice with success or failure in raising external finance. Thus, at this stage, this presents an opportunity to conduct further research within the Australian context.

Data and Methodology

The ABS undertook a Business Longitudinal Survey (BLS), which contains data on businesses for the periods 2004–2005, 2005–2006, and 2006–2007. The ABS BLS mainly used the following rating scales to elicit responses: Likert, dichotomous and category. The ABS BLS is divided into two panels and contains 407 variables. Panel one has three reference periods of data (2004–05; 2005–06; 2006–07) for 2,732 business records and panel two has two reference periods of data (2005–06; 2006–07) for 3,432 business records.

The ABS BLS contained six numerical variables: total sales, export sales, other GST-free sales, capital purchases, non-capital purchases, and expenses (total salary, wages and other payments). The coverage of the survey is extremely broad, and therefore offers an opportunity to explore the data for the analysis of the SME sector in Australia. One of the main advantages of the ABS BLS is that it offers information about the SME

sector that cannot be obtained from any other source, as it is, currently, the largest set of data on SMEs in Australia.

Only 2004-2005 periods is included in the analysis as in 2005-2006 and 2006-2007 this survey questions was not included. Thus, statistical analysis of the data on longitudinal basis was not possible. The analysis of the survey responses incorporates the use of descriptive statistics to study the effect of associations between variables. In order to see if there is a relationship between two nominal variables, cross tabulations method is applied.

Results

The period 2004-2005 in the BLS included questions about type of external advice that 741 SMEs sought. The response options included solicitors, business management consultants, other government organisations (federal, state, territory), financial advisors or banks, the Australian Taxation Office, others in the same industry, industry association/chamber of commerce, and external accountants.

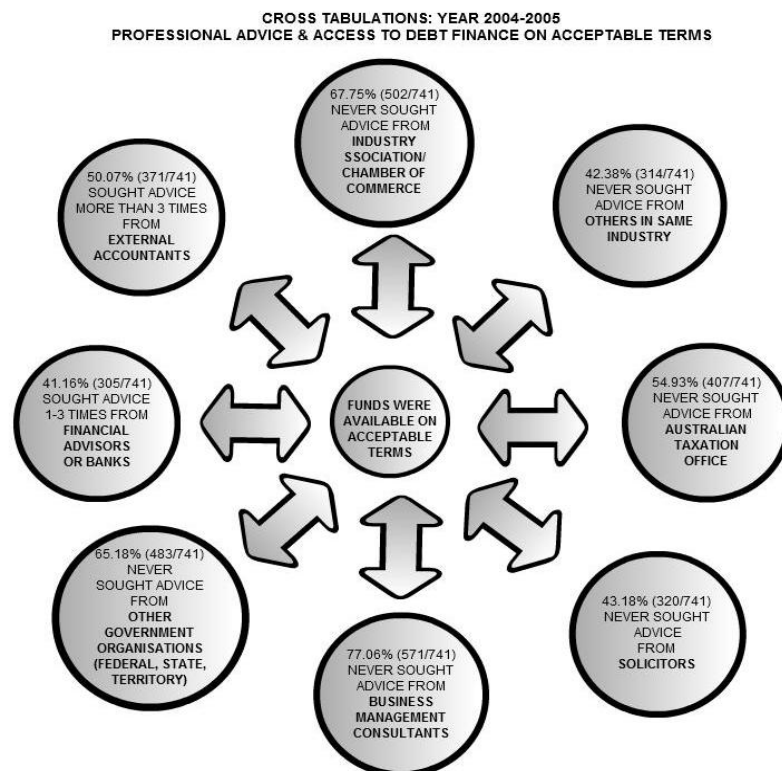


Figure 1: Professional advice
Source: ABS BLS (2007)

Significant numbers of respondents did not seek advice from business management consultants (77.05 percent), solicitors (43.18 percent), other government organisations (65.18 percent), the Australian Taxation Office (54.93 percent), others in the same industry (42.38 percent), and industry association/chamber of commerce (67.75 percent). More than half of the SMEs that obtained debt finance sought professional advice from external accountants (50.07 percent), and a considerable number sought advice from one to three times from financial advisers and banks (41.16 percent).

The statistical results bring to the attention the fact that majority of SMEs that successfully obtained external debt did not seek advice from government sources such as Australian Taxation Office or other government organisations. The value of government assistance to the SME sector depends on clear detection of constraints to performance and development, which should be followed by appropriate policies and programs to rectify them (Sarapaivanich & Kotey, 2006). A research study by Okura (2008) noted that businesses that apply for government assistance are inclined to adopt advanced accounting reporting, which enables the production of detailed financial statements.

In addition, the government should play a persistent role in promoting smaller businesses' stability and banking/finance needs (Council of Small Business in Australia, 2009). Government tools to promote SMEs should concentrate on making markets work efficiently and on encouraging the private sector to play an active role in SME finance (OECD, 2006). As statistical results indicated majority of SMEs that successfully obtained external debt finance did not seek advice from Industry Association/Chamber of Commerce, business management consultants, others in the same industry and solicitors.

A business that is entitled to receive government assistance tends to have access to accounting and legal services (Okura, 2008). The recent attention on SME financing also comes from the perception among academics and policymakers that SMEs experience constraints when accessing external financing, and therefore require special assistance from government programs that increase lending (World Bank, 2008).

Statistical results in this study resonate with earlier research results published by Bisman (2007) and Shailer (1999) in that SMEs view accountants as the most important source of external advice. As assistance provided by accountants with a loan application may provide credibility signals to a bank/financial institution (Shailer, 1999).

According to the statistical results in this research study SMEs' second most common source of external advice were financial advisors/banks. Generally, credit providers expect and demand financial report, statements and financial forecasts (Coleman & Carsky, 1999). One potential benefit that SMEs could gain from financial advisors is comprehensive information on the best credit product that suits their business needs and required documentation requirement for lodging a relevant application.

Concluding Comments

This research study reiterated the importance of SMEs' sources of external advice when accessing debt finance in Australia. The statistical results indicated that majority of SMEs that successfully obtained external debt finance did not seek advice from government sources such as Australian Taxation Office or other government organisations. Also it was evident that majority of SMEs that successfully obtained external debt finance did not seek advice from Industry Association/Chamber of Commerce, business management consultants, others in the same industry and solicitors. As a result, policy makers should pay closer attention to what type of support and advice government organisations provide to SMEs.

In addition, results of this research study showed that SMEs relied to a great extent on the advice received from accountants and financial advisors/banks. Previous research suggests that SMEs' usage of professional advice on loan application received from accountants and financial advisors may provide credibility signals to financial institutions. Findings of this research study have provided SME owner-managers with detailed information on the available sources of professional advice and their possible effect on access to external debt finance. Future research studies should include future

time periods and study the usage of sources of professional advice on a longitudinal basis.

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