



**ACCOUNTING PRACTICE AND ITS EFFECT ON ACCESS TO FINANCE
FROM DEVELOPMENT BANK OF ETHIOPIA; SURVEY STUDY ON THE
SMALL AND MEDIUM ENTERPRISES IN WERABE TOWN, ETHIOPIA**

ARGA SHURE

Department of Accounting and Finance,
Collage of Business and Economics, Werabe University,
Ethiopia

TARIKKECHEMA (PHD)

Department of Accounting and Finance,
Collage of Business and Economics, Werabe University,
Ethiopia

ABSTRACT

This study seeks to examine the accounting practice of small and medium sized enterprises and its effect on access to finance by the development bank of Ethiopia at Werabe town. 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 and ordinary least square regression. The study revealed that the majority of the studied firm has no formal accounting practice. From the sample SME 83 percent is the VAT register and maintain a VAT records. 20 percent, 32 percent, 24 percent, 53 percent, 14 percent and 47 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. The study also revealed that the major sources of finance available for the establishment and expansion of SMEs in Addis Ababa are personal saving, microfinance, money from friends or relative, iqub and less from banks. The result of ordinary least square regression evidences that variables such as capital, manager education level and age of the firms are the significant determinants of firms' accounting practices whereas the problems significantly associated with access to bank credits are the demand for collateral, accounting practice or formal accounting information and age of the firm.

KEYWORDS: Accounting, practice, enterprise.

1. Introduction

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).

Accounting information signals that decisions are needed, and provide information useful to making decisions (Gibson 1963 quoted in Thomas & Evanson 1987; 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).

Development Bank of Ethiopia (DBE) is one of the state-owned financial institutions engaged in providing short, medium and long term credits over the last 107 years. The Bank has been playing central role in promoting the over-all economic development of the Country since its establishment. In its over a century old service, DBE has established recognition at the national and international levels. Nationally, it is the sole Bank with reputable experience in long-term investment financing. Internationally, it is recognized as an important on-lending channel for development programs financed by bilateral and /or multilateral sources. The recent focus of the government in relation to the revised credit policy of DBE is to provide medium and long term loans for investment projects in the Government priority areas such as Commercial Agriculture, Agro-processing, Manufacturing Industries, Mining and Extractive Industries preferably, export focused as well as lease financing for Small and Medium Enterprises (DevelopmentBankofEthiopia,2020). 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 (World Bank 1978). As a result, SMEs pay high interest rates or fall back on the middlemen or moneylenders, 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).

Taken as a whole, this study examine the accounting practice of SME and its effect on access to finance, in order to provide meaningful insight and contribute to efforts aimed at expanding SME in the Werabe town and transforming small enterprises to medium sized enterprises.

1.2 Statement of the problem

The Development Bank of Ethiopia is a specialized financial institution established to promote the national development agenda through development finance and close technical support to viable projects from the priority areas of the government by mobilizing fund from domestic and foreign sources while ensuring its sustainability. The Bank earnestly believes that these highly valued objectives can best be served through continuous capacity building, customer focus and concern to the wider environment (Development Bank of Ethiopia, 2020). 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 (Arinaitwe 2006). SMEs frequently lack access to institutional credit (World Bank 1978), causing them to encounter high financing costs and high failure rates (Byron & Friedlob 1984). 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, 4) an over-reliance on external borrowings, and 5) 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 (Berryman 1982 quoted in Siop 1997, Walton 2000, Wichmann 1983, 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 (Ubonratchat hanee University 2000).

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 question

To construct an empirical study of the accounting practice and its effect on access to finance of SME's in Werabe town, Silate Zone, Ethiopia. Specifically the study aimed to responded the following research questions; - Is that SME does maintain formal accounting practice? - What are the determinants of the accounting practice of the SME. - What are the determinants of the access to credit of the SMEs. - How to identify the source of credit available to SMEs and the types of finance used.

2. Literature of Review

2.1 Accounting practices on Small and Medium Enterprise

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). Similarly other study found that SMEs that are concerned with procedural controls activities and use financial plan as part of their preparation for startup are more likely to employ computerized accounting system (Gorton 1999).

- **Financial Accounting issues:** 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). On the other hand, SMEs consider the most frequently used sources of information are the periodic management accounts, cash flow information and bank statements, to a lesser extent budgets, the state of order book and the additional annual accounts (Collis and Jarvis 2002).
- **Financial management:** 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). In the 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.
- **Cost and Management Accounting:** A study found similarities between costing systems used by SMEs and larger companies and 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 (Hopperetal.1999).

2.2 Access to finance and Development Bank of Ethiopia

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 Birr 20, 000 and not exceeding Birr 500,000 excluding high tech constancy firms (Manufacturing enterprises) and other high tech establishments(Addis Ababa MSME'S 2010). 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 Programme (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).

Development Bank o Ethiopia (2020), major area of focus is provision of medium and long-term loans for investment projects in the Government priority areas. In line with the Agriculture Development Led Industrialization Strategy (ADLI) of the Country, the Bank provides finance to encourage investment in Commercial Agriculture, Agro-processing Industries, Manufacturing Industries, Mining and Extractive Industries and lease financing for Small and Medium Enterprises (SMEs).

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 Werabe town, Ethiopia. Therefore, this study examined SMEs accounting practice and its effect on accessing finance in Addis Ababa to provide empirical evidence of this gap.

3. Methodology

Quantitative research approach particularly survey design were used and the data obtained were analyzed using descriptive statistics and ordinary least square regression. This study employs

simple correlation coefficients between the explanatory variables to test the presence or absence of multicollinearity. To start with, the models of accounting practice and access to finance developed under the empirical model section are estimated using simple ordinary least square (OLS) method.

Depending on the theoretical model and the measurements of the variables explained above, the empirical model that this study employs is given by:

$$ACP = \beta_0 + \beta_1 CAP + \beta_2 EDU + \beta_3 AGE + \varepsilon \dots \dots \dots (1)$$

Where;
 ACP: accounting practice
 β: coefficient
 CAP: Capital
 EDU: Education Qualification
 AGE: Age of the firm
 ε :error term

In the same manner, the empirical model of access to finance is given by:

$$AF = \alpha_0 + \alpha_1 COL + \alpha_2 ACP + \alpha_3 AGE + v \dots \dots \dots (2)$$

Where;
 AF: Access to finance
 α= coefficient
 COL: Collateral
 ACP: Accounting practice
 AGE: Age of the firm
 v= error term

4. Result of finding

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.

Table 4-1 Accounting tasks of SME

Practices/accounting tasks	Number	Percent (%)
Keeping records	112	100
Payroll	112	100
Taxation VAT	93	83
Bank statement	22	20
Income statement	36	32
Balance sheet	27	24
Period management account	60	53
Inventory and cost controls	53	47
Break even analysis	-	

Cash budget	7	6.25
Sales budget	8	7
Expense budget	8	7
Budget variance analysis	-	-
Ratio analysis	-	-
Working capital management	18	14

Sources: Survey result

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 83 percent is the VAT register and maintain a VAT records. 20 percent, 32 percent, 24 percent, 53 percent, 14 percent and 47 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 city.

4.2 Accounting practice of SME Regression results the output of regression on the accounting practice of SME is shown in the following table 4.2

Table 4-2: Results of ordinary least square regression for firm accounting practices

Accountings Practices	Coef.	St Err	P>t
Age	.0893091	.0009677	0.007
capital	17.32594	.2968292	0.011
Education	2.413027	.03533	0.009
Cons.	19.84139	.3181748	0.010

Sources: Survey result

The OLS regression result shows that the P-value of an independent variable age is (0.007). This suggests that the age of a firm is statistically significant determinant of accounting practice at 1 percent significant level. The fact that the coefficient of the variable is positive implies that the variable has a positive effect on accounting practice In the case of variable capital the OLS regression results revealed that capital has a significantly positive influence on firm accounting practice. The P-value of an independent variable capital is (0.011), which indicates that the capital has positively influence firm accounting practice at a 5 percent significant level. Truly coefficient of the variable is positive implies that the variable has a positive effect on accounting practice.

Similarly the OLS regression results revealed that the variable education has a significantly positive influence on firm accounting practice. Capital exerts a positive significant influence on firm accounting practice at a P-value of (0.009). Therefore, manager education is significant at a 1 percent significance level. The fact that the coefficient of the variable is positive implies that the variable has a positive effect on accounting practice. Finally the goodness fit of the model is tested using R square. The R square of a model explains how good the model is in explaining the

dependent variable. As shown in appendices table-2 the model is good fit at R square of 0.9999. This implies that the independent variables included in the model explain the dependent variable well and the better is the model.

4.3 Access to finance regression result.

The output of a regression on access to finance of SME is shown in the table 5-2 below.

Table 4-3: Results of ordinary least square regression for access to finance

Access of finance	Coef.	Std. Err	P>1
Collateral	2.361374	.1651681	0.044
Accounting practices	.3038975	.0198569	0.042
Age	0.627283	.0054186	0.055
Cons.	.8807507	..0590386	0.043

Sources: Survey result

The OLS regression results indicates that accounting practice positively influence the access to credit of the firm. That is accounting practice positively influence a firm access to credit at a P-value of (0.042). Therefore accounting practice is significant at a significant level of 5 percent. Coefficient of the variable is positive implies that the variable has a positive effect on access to finance. The result also reveals that collateral exerts a positive and significant influence on access to credit of the firm. The result indicates that collateral positively influence a firm access to credit at a P-value of (0.044). Therefore collateral is significant at a 5 percent significance level. The fact that the coefficient of the variable is positive implies that the variable has a positive effect on access to finance. Similarly the OLS regression result shows that the P-value of an independent variable age is (0.055). This suggests that the age of a firm is statistically significant determinant of accounting practice at 10 percent significant level. The fact that the coefficient of the variable is positive implies that the variable has a positive effect on access to finance. Finally the goodness fit of the model is tested using R square. The R square of a model explains how good the model is in explaining the dependent variable. As shown in appendices table-4 the model is good fit at R square of 0.9991. This implies that the independent variables included in the model explain the dependent variable well and the better is the model.

5. 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 Addis Ababa various reforms and development activities are being carried out. One of these is the promotion and development of SME's in the city. 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 Addis Ababa 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.

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 rates.

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