

FAILURE AND ASSISTANCE OF SMALL FIRMS

by Rolffe Peacock Copyright 2000

This overview considers what is meant by small business “failure” and then the rate of failures in Australia is studied. Research has indicated some root causes of small business failure which need to be differentiated from basic problems of smallness and also from symptoms of poor economic performance and failure.

What are the major areas of assistance needed by small business owner-managers? What is the role of the public accountant in relation to such assistance? These are key questions that also are examined.

After completing this overview you will:

- understand the meanings of small business “failure”;
- appreciate the significance and the extent of the failure rate of small business;
- understand the basic (generic) problems of smallness in business;
- appreciate the need for “small business doctors”;
- have learned the root causes of small business failure;
- understand the types of assistance that are needed by small business, especially from the public accountant;

There are two fundamental characteristics of small businesses which separate them from large companies. One is their smallness, and the other is their rate of turnover and failure rate. The following 1941 comment paints a pessimistic picture of the rapid turnover and pathology which has tended to remain with small business (Peacock 1984c):

The chance of a newcomer becoming an established member of the business community is sadly slight. He carries on until his funds are exhausted and then disappears from the scene. His place is taken by another hopeful, certain that he has the abilities which will permit him to succeed where his predecessor has failed Unaware of the odds against them, and largely ignorant of the weapons of trade, prospective proprietors march stolidly to the ambush. (Temporary National Economic Committee 1941).

Government policymakers in Western countries have been spurred on by what they see as the job generation potential of small firms. Therefore they have a concern for the small firm failure rate, ‘an acute interest in the divide which exists between failing and growing small firms’ (Lowe et. al 1990) and the differences between the characteristics of the two groups. Should government intervention be aimed at preventing failure, or encouraging growth, or a mix of both?

There is an important social side to the failure of small businesses, and this was demonstrated by the Beddall Inquiry (1990). One school of thought claims that the total proportion of businesses in the economy which are small tends to be stable and that a high closure (failure) rate is consistent with competition and vitality - ‘for every failure a new small business is established ... there are benefits arising from the elimination of less successful firms which make room for new entrants with fresh ideas..... People who fail in one business may learn from their mistakes in future ventures.’ (1) The alternative view is that a high incidence of failure is a serious waste of resources and there are not only economic, but also human, costs associated with failure. The Beddall Inquiry accepted the latter argument and concluded that in Australia ‘the failure rate in small business is a matter of concern.’

We commence with the question of the actual rate of failure of small firms in Australia.

SMALL BUSINESS FAILURE RATE

There are a number of different meanings that are attributed to the word "failure" as it applies to a small business. To the economist, this would be a business which earned a rate of return on investment which was insufficient to cover its opportunity cost i.e. it failed to be competitive with alternative uses of economic resources. This is not a useful approach for most purposes because we know that many proprietors trade off reduced profits for increased psychic satisfaction from the business, and in any case data is not available to make the necessary calculations.

The easiest meaning to understand and to measure is legal failure, where a small company is formally liquidated or in the case of an unincorporated enterprise the owner becomes bankrupt for business reasons. An alternative approach is to relate failure to the exit rate of owners or firms from the small business sector. Such discontinuances may include loss cutting procedures (to dispose of a business to avoid further losses), or because of a financial "failure to make a go of it" (Cochrane 1981) which would include, but not be limited to, legal failures.

In Australia, we have annual data from each State for bankruptcies due to business reasons, and limited information regarding the liquidation of small companies. (2) There are however no official long-term statistics regarding the entrance and exit rates of small business - the Portrait (1997) is the start of a federal government sustainable data base which may serve this purpose. (3) The limited information outlined below is the result of academic research studies. (4)

LEGAL FAILURE

In South Australia the bankruptcy and liquidation of small businesses was studied for the period 1974-85. Of 418 unincorporated businesses which became bankrupt in the four years ended June 30 1985, 50% failed within the first 2 years, and 86% within 5 years; only 4% survived after 10 years (Peacock et. al 1986, 1988). Of 779 proprietary companies liquidated from 1974 -84, 33% failed within 2 years, 54% within 5 years and 21% after 10 years (Peacock 1984b, 1985a, b). Similar results were found for 432 proprietary companies in Queensland for 1970-76 (Sorby-Adams 1981), and for 863 proprietary companies and unincorporated businesses in Western Australia and Victoria where 41% failed within 2 years and 69% within 5 years of start (Williams 1975). Lowe et. al (1990) found that for 1987-88 and 1988-89 about 34% of failed New South Wales small companies did so within 3 years of start, and only 12% survived more than 10 years.

Although these studies were completed at different times and in differing States, they all indicate that the rate of small business failure decreases with the age of the firm.

DISCONTINUANCE OF SMALL BUSINESS

Price (1984) studied the exits of Victorian manufacturing enterprises (less than 100 employees) from 1966 - 77, and found the average annual exit rate to be 3%. As the birth rate was estimated to average 3.3% p.a., the net rate of growth was 0.3% p.a. He also suggested that the closure rates of non-manufacturing enterprises was about 3.5% p.a. An earlier 1978 study in New South Wales of 2,563 small businesses indicated a higher closure rate:

..... approximately 19% of the firms in existence in 1973 had closed by 1978 (29% was the most pessimistic estimate of closures during the period). These estimates suggest an annual closure rate of approximately 4 - 6%. (BIE 1985).

FAILURE "TO MAKE A GO OF IT"

The only national longitudinal study of small business starts and exits in Australia was instituted by Williams (1987). It commenced with business starts in 1973 and is still being regularly updated. By

1990, 33,624 start ups had been studied in all industry sectors (Reynolds et. al 1994). The definition of failure that has been adopted is the inability of the owner-manager to continue because of financial difficulties:

A termination of business is deemed to be a failure if the firm ceases operating under its existing owners and structure because it is unable to function profitably, or does so because of existing or impending failure, insolvency or financial difficulty. (Williams 1987).

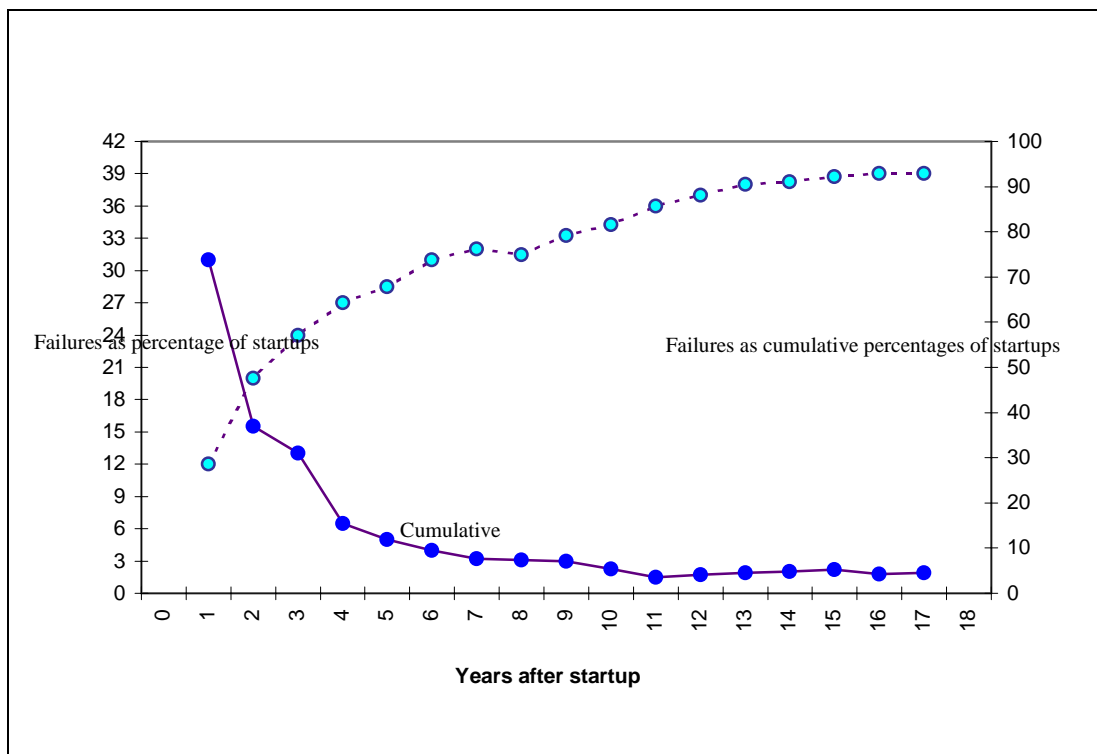
Closure due to ill health, domestic discord, death or personal reasons are not included in the definition and therefore the results are more conservative by excluding such reasons for closure.

Reference to Figure 1 shows the failure rates from the research study. (5)

FIGURE 1

SMALL BUSINESS FAILURE RATES (1973 - 90)

Source: W. Reynolds, W. Savage and A. Williams, *Your Own Business. A Practical Guide to Success* (Sydney: ITP Thomas Nelson, 2/e 1994), p. 38.



The percentages of the start ups which failed comprised:

| <u>No. of years after start</u> | <u>% of failed firms</u> | <u>Cumulative % of failed firms</u> |
|---------------------------------|--------------------------|-------------------------------------|
|---------------------------------|--------------------------|-------------------------------------|

| | | |
|---|-----|-----|
| 1 | 32% | 32% |
| 2 | 17 | 49 |
| 3 | 13 | 62 |
| 4 | 7 | 69 |
| 5 | 5 | 74 |

In the first year nearly one third of all start ups failed on the average. The proportion of failures then declined for each subsequent year but the cumulative failure rates are high - 62% after 3 years and 74% after 5 years. In other words, no more than about one quarter of enterprises have survived 5 years. As shown in Figure 1 a more gradual rate of decline then occurs until about year 11 and then tends to stabilise. In commenting on the data, Reynolds et. al (1994) said that 'It is estimated that up to 30,000 businesses fail in Australia annually - almost 100 every working day! a huge waste of human and economic resources.'

There have been criticisms of the Williams study (Haswell and Holmes 1989), but research conducted in the US has reported similar results (Churchill 1952; Star and Massel 1981) and high failure rates have been reported in the UK (Hill 1987; Storey et. al 1987; Keeble 1990).

FAILURE IN MANAGED SHOPPING CENTRES

Watson and Everett (1995) have used five definitions of "failure" in their survey of 5,196 start ups of retail and service establishments from 1961-90. All firms were in managed shopping centres where the researchers were able access data because 'Managed shopping centres keep appropriate information on their current, and past, tenants.' Key results are shown in Table 1. (6)

TABLE 1

FAILURE RATES IN MANAGED SHOPPING CENTRES

Source: adapted from J. Watson and J Everett, "Do Small Businesses Have a Higher Failure Rate?" in W. Dunlop and B. Gibson (eds.), *Conference Series no. 23* (Newcastle: University of Newcastle, 1995).

| <u>Failure definition</u> | <u>1-5 years</u> | <u>6-10 years</u> | <u>>10 years</u> | <u>Average</u> |
|------------------------------|------------------|-------------------|---------------------|----------------|
| Legal failure | 0.9% | 0.5% | 0.2% | 0.7% |
| Discontinuance of business | 4.7 | 4.3 | 2.9 | 4.3 |
| Failure to "make a go of it" | 5.4 | 3.2 | 2.1 | 4.4 |

As in studies of legal failures and the Williams study, the Watson and Everett study indicates that age is a significant factor in small business failure - the probability of failure declines as businesses increase their learning in the first 5 years, to the second 5 years, and beyond.

Data using the "legal failure" definition in Table 1 cannot be directly compared to the William's survey which adopts a much wider definition. There is however a much smaller failure rate for all time periods using the other two definitions when compared to the William's data. One reason could be that only retail and service establishments are involved in the managed shopping centre study, but the researchers have responded that these comprise nearly 70% of all small businesses. More critical concerns could be that not all such firms operate in managed centres, and the study omits home based businesses which comprise about 55% of small businesses with less than 20 employees (ABS, Cat. 8127.0, 1998). (7) The results however provide food for thought and have led at least one writer to say that 'New evidence suggests that small business failure rates are not as high as was once thought' (English 1995).

There has been more extensive research into small business failures in the UK than in Australia and in summing up the UK results, Storey (1994) provides a picture which seems to be similar for Australia:

The broad pattern which emerges is that the young are more likely to fail than the old, the very small are more likely to fail than their larger counterparts, and that, for young firms, probably the most powerful influence on their survival is whether or not they grow within a short period after starting.

Berryman (1994) summarised mainstream small business failure literature for the prior decade and concluded that, 'It seems that there is little to be gained from more research to determine failure statistics. There is still disagreement, but one factor seems to be unreservedly agreed and that is that firms are more vulnerable when they are young.' Nevertheless, the debate concerning small business failure rates will no doubt continue in Australia and elsewhere as long as there is a lack of official statistics on enterprise formation (births) and failures (deaths).

We now proceed to examine the causes of failures in the small business sector.

CAUSES OF SMALL BUSINESS FAILURE

Jennings and Beaver (1995) were critical of many studies of small business failure because they tended to focus on symptoms or 'reasons cited for failure' by proprietors rather than the root causes of failure. We need to recognise three levels of "causes". First of all there are inherent or generic problems of smallness and the key one is the dependence of the firm on only one owner-manager in most cases. Then there are root causes of failure that can be detected for individual firms, such as a lack of finance or poor management. Also there are symptoms of problems or failure which proprietors tend to confuse with root causes. For example, a lack of inventory or poor planning may be a symptom of incompetent management and to remedy either symptom will not solve the key problem. Some symptoms may not present themselves to the proprietor because of a lack of expertise or the right type of information. The doctor-patient analogy in the following Small Business Highlight illustrates the three levels of "causes".

SMALL BUSINESS HIGHLIGHT

THE NEED FOR SMALL BUSINESS DOCTORS

In 1985 the federal Minister for Science, Barry Jones, complained that it was difficult to help small business people because 'they were often unable to pin-point their problems' (Advertiser, July 13 1985, p. 23). He compared them to 'patients who walked into a doctor's surgery and could not say where their pain was.'

In his book addressed to small business financial advisers, and especially public accountants, Back (1985) said that they needed to be "doctors of small business." This meant that they had to understand the generic problems of smallness:

..... just as modern medical practitioners need to know the anatomy and physiology of the human body and the environmental conditions in which humans work and which influence human behaviour, so financial advisers need to know the anatomy and physiology of small business and the environmental conditions in which small firms work and which influence small business behaviour.

It was also essential to get to know the patient before attempting to make a diagnosis and prescribing treatment:

It's as important for the physician to know what sort of patient has the disease as it is to know what sort of disease the patient has. It would be horrifying to think a medical practitioner would prescribe drugs for a complaint without examining the patient and without having a knowledge of the medical history and the effect of the patient's personality on any illness or potential cure. The financial adviser who gives advice without an adequate diagnosis is the equivalent of a doctor prescribing dangerous drugs without a proper examination. And it can be just as fatal.

Back's complaint was that the education and training of financial advisers in the small business discipline was virtually non-existent so that they were poorly equipped to become proficient business doctors.

R. Price (1984), in discussing in his book, "Why Problems Arise in Small Business", also used the medical parallel and stressed that small business owner-managers were often aware of vague symptoms and problems, but that even if they were "fixed", they still felt poorly. This was because a diagnosis was needed of the cause-and-effect relationship between immediate problems and root causes:

..... the complaint that a small business has insufficient finance, may be precipitated by a numerous variety of factors, such as poor management, theft, overstocking, and a whole lot of other factors. The expedient of supplying more finance in these circumstances cannot be held to provide any more lasting good than supplying food to a person with a chronic enzyme deficiency.

In 1988 the federal government launched a national scheme called the National Small Business Information and Awareness Program. The aim of the scheme was to make small business people aware of the need to 'lift their management game', and to focus on the broad range of facilities available to them. This was to be implemented by small business government agencies, accountants, bankers and solicitors, among their small business contacts. In South Australia, the program was called the "Business Doctor". The first step was to train the providers in the small business discipline, as suggested by Back, because '..... the accountants, bank managers and other specialists often do not see small business needs from the same perspective as small business people themselves' (Newell 1988).

Hailey (1997), a consultant specialising in planning and marketing for small business, recommended to accountants that they needed to be general practitioners and not just financial specialists, 'Take a holistic approach. Looking only at financial issues is akin to a doctor treating a sore throat without asking how the patient otherwise feels'.

The concept of the small business doctor now has a long history. It is assumed that advisers are adequately educated and trained in their own business discipline such as accountancy or finance, but they also need specific education and training in the discipline of small business studies. To provide a full diagnostic service they need to understand the basic problems of smallness, and be prepared to spend time in understanding the patient and communicating with them. A knowledge of the patient's presenting, and non-presenting, symptoms, should lead to diagnosis of the root cause and specified treatment. It may often be necessary to refer the patient to a specialist in non-financial matters. In any case, appointments need to be made for feed-back and any continuing treatment. If the patient is in good shape, regular check-ups may be needed only quarterly perhaps. If the patient is not strong (and in many small firms, this means being young rather than elderly), more regular checkups may be advisable.

There are inherent or generic "problems of smallness" which apply to all small businesses in varying degrees.

BASIC PROBLEMS OF SMALLNESS IN BUSINESS

1. The owner is the business.

The first national inquiry into small business in Australia (Wiltshire Inquiry 1974) was asked to explore 'ways of providing guidance to small business management to help in improving efficiency.' The inquiry was convinced of the 'quite special nature of (small business) problems' and its following definition of a small business establishes the first basic problem of smallness:

A business in which one or two persons are required to make all the critical management decisions: finance, accounting, personnel, purchasing, processing or servicing, marketing, selling, without the aid of internal specialists and with specific knowledge in only one or two functional areas.

The business depends at the start, and often for a long time afterwards, upon the personal characteristics, abilities and resources of the owner-manager. There is an initial shortage in resources to manage the firm, unlike the big firm with a number of managers/supervisors for different functions. In Chapter 5 (Managing the small business) we have discussed the problems the proprietor has in carrying out both general and functional management within a learning organisation. They have to make all the decisions and this becomes even more critical as the firm develops.

2. Isolation.

Small business managers do not have opportunities for mutual discussion or for the sharing of problems which are available to management in larger companies. (Wiltshire Inquiry 1974).

There is no doubt that many people start their own business motivated at least in part by a need for independence and to control their own destiny, but this can mean isolation from peers, colleagues and specialists that are available to managers in a large organisation. Gumpert and Boyd (1983) summarised the effects of 'the loneliness of the small business owner' based on their research:

Smaller ventures have little room at the top. At the beginning, the people in charge and those at the bottom are usually one and the same. And even after the survival stage has passed, small companies tend to run lean because their limited resources are typically used to maximise sales and production rather than

to recruit managerial talent. Founders fill in the lower levels through hiring, while keeping authority in their own hands. As a consequence, entrepreneurs often lack colleagues with whom to share experiences, explore ideas, and commiserate.

..... at work he has no equals in stature or responsibility.

..... without input from peers, friends, or family, entrepreneurs are unlikely to consider all relevant options and risks in their decision making.

All you're getting is your own feedback.

3. Lack of information.

Friedlander and Pickle (1968) said that small firms tend to treat the organisation as a closed system by concentrating upon principles of internal functioning as if these were independent of the external environment. Such firms therefore tend to look for solutions to problems within the firm; however, there is only limited information within a small firm because there is only one manager (or a small team), isolated from other managers and specialists, and a general lack of resources including information. There tends to be a lack of information acquired by small firms because of an unawareness that it is needed:

An imbalance of functional skills can lead to a failure to recognise, or tardiness in recognising, impending difficulties and the need to find early solutions. Where such a lack of awareness exists it explains a failure to seek outside advice or to acquire the knowledge which would avoid such difficulties. (Wiltshire Inquiry 1974).

In a small firm the problem may occur at point A (poor inventory control) but is manifest at point B (illiquidity). If the owner does not perceive B, or even if they do but do not relate it to A, they may not seek advice or assistance.

4. Lack of time.

The problem factors to date indicate a high work load for the owner-manager. *Yellow Pages Australia Small Business Index* (November 1993) found that hours of work (averaging 58 hours per week) were the primary negative for the proprietor, resulting in too little leisure time for 68% of respondents.

5. Pressure.

According to the Wiltshire Inquiry (1974):

The responsibility imposed on one or two persons for all management decisions usually leads them into working long hours in an atmosphere of constant pressure. This pressure is partly due to lack of management know-how and has the unfortunate result of preventing participation in activities designed to alleviate these pressures

Maguire and Kench (1974), in a survey of the information needs of small manufacturers in New South Wales, found a constant sense of urgency in proprietors leading them to avoid searching for information and waiting for external advice.

6. Product dedication.

Although it is often argued that an advantage of smallness is flexibility, small firms also tend to be "more product-dedicated" than big firms; they are likely to be dominated by the things they make or the services they render (Cohn and Lindberg 1974). Because they have much smaller portfolios of products/services than large firms, it is more difficult for them to shift easily to something radically different. Because they are more product intensive, small firms tend tie their objectives much more closely to the product line than other matters such as the use of funds, training of staff or planning, resulting in undiversified objectives, strategies and performance which do little to reduce the inherent riskiness of the small firm.

7. External changes are critical.

External forces tend to have more impact on small business than on large firms which have deeper resources to cushion change. Changes in issues such as government regulations, employment requirements and industrial relations, finance charges and interest rates, can make a major impact on a small business.

8. Small businesses are seldom in equilibrium or even near it.

In large firms, rates of change and growth rates are normally smaller than for the volatile small business and their financial statements tend to 'describe a system in approximate equilibrium' (Welsh and White 1981). Today's markets and competition are more volatile and fluid than in previous decades but large companies have available strategies unknown to the small firm - diversification of operations and geographical locations, control over parts of the environment, and buffer resources to draw upon. Small businesses are seldom in equilibrium or even near it, and a picture of changes and learning is more appropriate. Because many of the models, principles and prescriptions of business disciplines such as economics, accountancy, business finance and management are based on steady-state situations they are of little relevance to the small firm.

9. High business risk.

Factors such as those above are unique to the small enterprise and 'create a special condition which can be referred to as *resource poverty* - that distinguishes them from their larger counterparts and requires some different management approaches' (Welsh and White 1981). These limitations create a high degree of inherent riskiness in small business; mistakes and misjudgments can result in closure and failure. One of the solutions for the resource poverty problem is that the strategic objectives of small firms need to include a continuous maintenance of liquidity. Long-term success and profitability can be threatened unless specific actions are taken to counteract the basic problems of smallness - "liquidity is a matter of life and death". A high degree of business risk is a facet of the small business sector and is recognised by investors who require very high rates of return for providing equity in small unlisted firms.

Given a background of the generic problems of the small business, we now turn to what we know about causes of failure according to research studies.

ROOT CAUSES OF SMALL BUSINESS FAILURE

In the 1930s in the US, management deficiencies were claimed to be related to business failure by Cover (1933) who said that 'discernible errors in management' were a major cause of retail bankruptcies. Dun and Bradstreet studies have consistently found that causes due to poor management predominate in failures (Peacock 1985c):

- US business failures, 92% due to management,
- US 17,000 business failures, 94% due to management, and
- Canada 2,598 business failures, 96% due to management.

In the study of South Australian legal failures referred to earlier for 1974-85 the predominant cause of failure was management inefficiency (incompetence and inexperience) - for 81% of companies and 91% of unincorporated firms. According to national annual reports under the Bankruptcy Act, internal factors relating to the quality of management are reported as major or contributing causes of failure at least as twice as often as factors external to the firm (Williams 1986; McMahan et. al 1993). Similarly, business consultants claimed that 90% of business failures were due to management inadequacy (48% incompetence and 42% inexperience) (Perry and Pendelton 1983).

In 1983 and again in 1994 J. Berryman surveyed and analysed the small business literature regarding small business failure. In 1983 she classified the causes of failure into three categories - management inefficiency (endogenous factors), exogenous factors and behavioural aspects of owner-managers, and in 1994 she added a fourth category of characteristics of the firm. Tables were compiled in each paper indicating the percentages of surveyed references giving specific causes of failure. In combining the two

tables, 76% of causes were attributed to management inefficiency, 16% to exogenous factors and 8% to behavioural characteristics of the owner-manager and characteristics of the firm.

In Williams' (1986) study, 5,456 failed owners were asked to provide up to 5 reasons why their enterprise had failed. Of all responses, 18% comprised exogenous (uncontrollable) reasons and 82% were endogenous reasons (subject to management control). Williams used the whole of his data base of surviving and failed firms to statistically investigate the relationship between a number of variables and "survival-ability" of firms. He found the duration and relevance of management experience (as an employee prior to starting a business) greatly increased the probability of survival. 19 factors were used individually to analyse the management practices and business dynamics of all firms. A comparison between survival/failure and the combined factors found a 'highly significant relationship between the overall quality of managerial performance and survival-ability' (chi-square = 14; df = 4; $p < .001$).

There is agreement between small business owners and the small business literature that management inefficiency is the underlying root cause of small business failure, and therefore probably the main cause of many of the problems of surviving firms.

Another key cause of failure could be a lack of finance. Of the South Australian legal failures, 17% of companies and 13% of unincorporated firms claimed that lack of finance was a cause of failure. In the Williams' survey 8% of owners said that an inability to borrow needed funds was a major reason for failure. According to Berryman, lack of finance was a causal factor in 6% (1983) and 2% (1994) of references. However, it needs to be noted that failed owners were the source of evidence in some of the studies, so that the problem may still be at least a managerial one because of an unawareness of fund sources and an inability to present adequate proposals for funding - this tended to be the view of the Wiltshire Inquiry (1974). The Beddall Inquiry (1991) agreed, but conceded that more research was needed regarding the availability of finance. The results of subsequent research suggest that it is not clear that financing problems lead directly to failure. Many financing problems are more likely to arise from the needs of growth firms wishing to expand further.

Poor financial management.

In the Berryman surveys the predominant aspect of management inefficiency (76% of references) responsible for failure was financial management in 45% of references. (8) Within the finance function, accounting was the biggest problem (13% of references in 1983 and 5% in 1994), because of 'inadequate or no accounting records' and 'deficiency in accounting knowledge'. Other key aspects of the finance function ranked in order of importance were:

1. Credit management
2. Inventory control
3. Cash flow analysis / liquidity
4. Lack of initial capital
5. Control of accounts payable
6. Administration of fixed assets
7. Lack of finance

Berryman (1994) reclassified her latest findings in terms of management functions as follows:

| | <u>% of articles</u> |
|-----------------------------------|----------------------|
| Financial management and planning | 28 |
| Marketing management | 16 |
| Operational management | 15 |
| Human resources management | 6 |

| | | |
|--|-------|----|
| Strategic management | 5 | |
| | <hr/> | |
| Management inefficiency | 70 | |
| | <hr/> | |
| Exogenous factors | 16 | |
| Characteristics / behaviour of owner-manager | | 13 |
| Characteristics of firm | | 1 |
| | <hr/> | |
| | 100% | |
| | <hr/> | |

The finance function is again shown as the predominant cause for concern within the small business failure literature.

Williams (1986) placed the major reasons for failure given by failed owners into major groups ranked as follows: (9)

| <u>Rank</u> | <u>Reasons</u> | <u>% of all responses</u> | |
|-------------|--|---------------------------|-----|
| 1 | Financial management | | 28% |
| 2 | Accounting | 16 | |
| 3 | Management incompetence and inexperience | | 15 |
| 4 | Employment relations | 15 | |
| 5 | Inflation and economic conditions | | 12 |
| 6 | Sales/marketing problems | 11 | |
| 7 | Failure to seek and use external advice | 3 | |
| | | <hr/> | |
| | | 100% | |
| | | <hr/> | |

As found by Berryman, the main causes of failure were in the finance functions of the firms - 44% of responses including 16% in accounting.

Poor aspects of the finance function were found below in failed firms by Williams. There were poor accounting records in 55% of firms and an inability to use financial statements in 18% of firms.

| <u>Rank</u> | <u>Reasons</u> | <u>% of failed firms</u> | |
|-------------|--|--------------------------|-----|
| 1 | Accounting - inadequate, inaccurate, non-existent books and records | | 55% |
| 2 | Excessive private drawings | | 22 |
| 3 | Undercapitalisation (particularly at start) | | 21 |
| 3 | Overuse of credit (bad debts and slow collections) | | 21 |
| 5 | Inventory problems | | 20 |
| 6 | Accounting - inability to use/understand financial reports and statements | | 18 |
| 7 | Lack of financial planning | 17 | |
| 8 | Inability to borrow needed funds | 8 | |
| 9 | Unproductive use of assets | 7 | |
| 10 | Acting without adequate risk assessment; over reliance on gearing; inability to assess risk associated with expansion and new investment | | 6 |
| 11 | Premature expansion | 5 | |

Williams found statistical evidence of positive relationships between the following financial variables and "survival-ability."

- Adequacy of accounting records.

The range of accounting records in each firm was determined and there was found to be a significant correlation between the adequacy of the records for making decisions and survival.

- Frequency of accounting reports.

The ability to make effective decisions is affected by the regularity with which accounting data is presented to managers in meaningful reports. There was a statistically significant relation between the frequency of reports and survival.

- Use of financial data for managing.

The main use of accounting information in the small firm, apart from taxation purposes, should be to assist in management of the firm. In addition to the existence and frequency of use of accounting data it was found that the use of financial reports in making decisions was positively related to business performance.

- Financial management.

All firms were asked annually to indicate their major problems, and as a result cashflow difficulties were ranked as no. 1 for both survivors and failures, and failed firms indicated that financial management and illiquidity were the major reasons for failure. It seemed likely then that the quality and attention given to financial management would be consistent with survival, and this was found to be true statistically.

Poor financial management was given as the major cause of failure in the latest report of the Attorney-General regarding business bankruptcies (Attorney-General 1997). 24.7% of major causes were attributed to lack of capital (10%), failure to keep proper books (1.7%), excessive interest (7.4%), inability to collect debts (3%), and excessive drawings (2.6%). (10)

Although it is accepted that management inefficiency is the root cause of small business failure, it seems that inefficient management of the finance function is the most critical aspect of functional management, and this includes poor accounting.

Other poor management

Researchers and writers have placed less emphasis on non-financial aspects of functional management as a cause of failure. According to Berryman (1983, 1994) 16% of writers mentioned marketing management as a causal factor. Williams said that sales/marketing problems occurred in 11% of responses and found a positive correlation between sales/marketing effectiveness and reputation/business image and survival. Berryman said that 6% of writers mentioned human resource management. 15% of responses to Williams referred to problems in employment relations, and he found that 'hiring and motivating employees (people management)' was related to survival.

SUMMARY

All small business owner-managers face the basic problems of smallness but they bring to their task differing personal and economic resources. Also, the type of business, industry sector and market niche may be more or less risky in terms of generic problems. If any of the generic hurdles can be removed or reduced this would seem to be a function of government policy which we will discuss in Chapter 14 (Small business - government interface).

In diagnosing the root causes of small firm failure it should not be surprising that this turns out to be the management inefficiency of owner-managers. The 9 basic problems of smallness create the "ambush" for prospective proprietors, many of whom prove to be inexperienced or inadequate. reviewed the general. At the start, a small firm depends often on only one person (the proprietor) to marshal the motivations and resources of internal and external stakeholders in an uncertain environment. As the organisation develops

it has to adapt to changing circumstances and 'failure to adapt to a series of "crises" caused by growth is one of the principal causes of failure' (Greiner 1972). The evidence is that a large proportion of starters do not have the competence to handle the management that is needed, and in many cases this is brought out in the very early stages of the venture. The Karpin Inquiry (1995), in contrasting the management of Australian SMEs to world best practice, found that although there was a distance still to go in customer orientation, entrepreneurship, and functional skills, strategic skills and management development were the most deficient aspects.

An inadequately managed finance function has been the main functional problem for failed small enterprises, and this includes poor accounting. 'The positive correlation between poor or nil financial management (including basic accounting) and business failure has been well documented in Western countries' (Peacock 1985b). Because of the evidence that financial problems are a major concern for many small businesses, it seems likely that survivors have a lower financial performance than would be possible with better financial expertise (Callus et al 1992; Roberts April 7 1994; ASCPA 1994; Morehead et al 1997). The financial problem may be partly due to a lack of a financial background for many starters. They bring to the venture only a technical speciality (building, plumbing, engineering) or a non-financial profession such as marketing or computing. Also, because psychic satisfactions such as independence and quality of life are as much sought, or more sought, than financial returns, financial aspects of the business tend to be neglected.

There is no doubt that exogenous factors such as government "red tape" and legislation, interest rates, taxation and the state of the economy, have some impact on failure rates, as shown by Berryman and Williams. However, these tend to affect all firms and it is likely that the survivors are generally those with better general and financial management.

In the next section we focus on the assistance that seems to be required to reduce management inefficiency within the small business sector.

ASSISTANCE FOR SMALL BUSINESS

The most adverse result of a lack of management skills is failure, but incompetence and inexperience in management creates problems and sub-optimal performance for surviving firms, and there is a need therefore for assistance to improve small business management efficiency. We concentrate on four main areas of assistance in start up preparation, business and management education, training and advisory services.

NEED FOR START UP PREPARATION

Williams (1986) found that there was a significant relationship between the nature and extent of intenders' preparation for start up and survival. The greater the amount of consultation with knowledgeable persons and other sources of information, the better the chances of success, but he found a general lack of preparation in most cases. This was a large concern of the Beddall Inquiry (1991) which complained that 'Despite the numerous sources available (government agencies, TAFE, trade and professional associations, chambers of commerce) people intending to start up a small business show a reluctance to use them.' The Karpin Inquiry (1995) agreed that there was a need to encourage and prepare intending proprietors and argued that although there were numerous short familiarisation courses in Australia, more thorough and intensive programs were also needed.

NEED FOR BUSINESS AND MANAGEMENT EDUCATION

The Bureau of Industry Economics (Williams 1991) sponsored a study by A. J. Williams of the survival rate of small firms and the role of formal education, management training and advisory services. The research sample comprised 51,377 firms for 1973-90.

Williams found that only 39% of owner-managers went beyond high school, but only 25% of these achieved a tertiary level qualification. (11) There appeared to be no relation between the general level of education achieved and failure rates. However, the content of higher level studies was important; studies in technical and professional subjects relevant to the type of business were positively related to management skills and survival. The downside was that 43% of proprietors had no such studies and only 25% had more than one years duration.

Less than half of all proprietors had ever studied business-type subjects (bookkeeping, management, finance, supervision), 36% had studied these at secondary school and 12% at tertiary level. There was however a significantly positive correlation between the quality of management skills and survival, and the length and level of such studies.

Both the Beddall and Karpin Inquiries believed strongly that the neglected part of “start up preparation” was basic business education prior to starting a business. The Beddall Inquiry recommended that: *The Department of Industry, Technology and Commerce provide a heightened awareness campaign to potential small business start ups to drive home the value of business management training before commencement.*

Because it is so difficult to persuade existing proprietors to formally improve their management skills by further education once they are involved in their business, a lot of emphasis has been placed by policymakers and commentators on education prior to starting:

..... a small business management course delivered to students and apprentices via the education system is the most effective way to provide basic management training (Beddall Inquiry 1990).

What is the role of universities in regard to small business culture and the education of small business owner-managers? It is known that small business studies are taught in a minority of universities, contrary to the intentions of the Beddall and Karpin Inquiries. In a recent study at the University of South Australia it was found that 25% of all graduates had become small business proprietors and 26% had provided professional advice or acted as consultants to small firms, although small business studies were taught in only one school for some of the surveyed period

NEED FOR MANAGEMENT TRAINING

Williams (1991) found that 68% of proprietors had never attended a management training course and that only 12% had been involved in three or more such courses. There was however a significant relationship between frequency of involvement in training and survival, and it would seem reasonable that this was due an improvement in management skills. Also, proprietors with formal education at a tertiary level were much more likely to undertake such training.

The Wiltshire Inquiry (1974) said that one of its most important recommendations was that ‘means must be found to encourage small business people to seek knowledge and training. Propaganda steps need to be taken to make fully attractive to these managers the whole idea of business education’, but conceded that ‘the task of getting through to the small business person is a formidable one.’ 20 years later the Beddall Inquiry said that although there was in existence a ‘training and advisory industry grown up around the small business community’ and an abundance of available services, there was a ‘lack of penetration of (management training courses) into the client group’ and recommended that:

State small business development agencies liaise with the various industry, trade and professional associations to develop industry specific business management education and training programs.

The Karpin Inquiry also made recommendations for management training in its framework for improving SME management skills.

Despite a large small business literature on training (Ulrich and Cole 1987; Curran and Stanworth 1989; Breen and Hall 1990; Gallagher 1991; Christie 1992; Stanworth and Gray 1992) and the existence of a training industry the vast majority of small business owner-managers fail to improve their “weapons of trade” by training. One reason may be the nexus between tertiary level education and subsequent training, hence the stress by the Karpin Inquiry for all students at tertiary level to be made aware of the small

business culture and its possibilities for employment as managers and also as advisors, trainers and policymakers.

Other reasons amplified by the BIE and Williams lie with the training industry, as indicated by the following views:

..... Australia does not yet have a major, distinctive and effective supply of high quality management training for small firms from a national perspective, management training for small firms has been, and still is seriously deficient, although some notable exceptions do exist.

..... many well-meaning education institutions have been offering a wide variety of courses in small business management. With some exceptions, such courses have been poorly planned and marketed, with suppliers still unable to interest at least two thirds of their potential market in buying their product.

The major factor underlying negative attitudes about training by so many of those who need it, is the credibility gap between them and the suppliers.Suppliers must more accurately understand the driving force in all small firms (the owner-manager), the small firm itself and its training needs, and act upon such matters as content, trainer, competence, training methods, location, timing and price in marketing their products.

While there are numerous specific reasons for this situation, the inevitable conclusion can only be that suppliers have not given due attention to the marketing of their products.

NEED FOR ADVISORY SERVICES

The Wilshire Inquiry coined the term “multiplier” agencies for small business providers such as trade organisations, educational institutions and professional associations of accountants, bank managers and solicitors. Each provider has its own specific advisory role but also can promote a multiplier effect by referring clients to other providers.

In 1985 there were three surveys regarding the use of advisers by small firms. In South Australia, 768 proprietors (less than 100 employees) were asked for details of their “sources of advice, assistance and information” (Peacock 1987) and their responses comprised: (12)

| | <u>% of firms</u> |
|-------------------------------------|-------------------|
| Informal advice: | |
| Employees | 52% |
| Suppliers | 36 |
| People in similar business | 32 |
| Friends | 21 |
| Professional advice: | |
| Accountants | 52 |
| Banks | 37 |
| Solicitors | 21 |
| Management consultants | 6 |
| Other: | |
| Trade or professional organisations | 23 |
| Media | 19 |
| Educational institutions | 10 |
| Service clubs | 5 |
| Miscellaneous | 6 |

Chief sources of advice were informal and local, and the chief professional advisers were accountants, bankers and solicitors.

A household survey in February 1995 (ABS, Cat. 8127.0, 1996) found that in 12 months prior to the survey, 76% of small firms (less than 20 employees) consulted some form of external advisory service. The main ones were accountants (65% of firms), banks (43%) and solicitors (23%). Advice from government small business agencies was sought by only 6% of firms. (13)

Yellow Pages Australia Small Business Index (September 1995) asked proprietors (less than 20 employees) for their sources of financial advice. Informal sources comprised 25% of responses and the chief

professional advisers were accountants (80% of responses), bank managers (15%) and financial advisers (10%). Only 2% of firms had accessed government agencies or small business centres. When asked for their principal source of financial advice, the main one was the accountant (63% of responses) - 24% had no main source, 8% named informal sources and 5% had other formal sources.

In all three surveys it was clear that the three main professional advisers to small business were accountants, bank managers and to a lesser extent, solicitors. In May 1988 the Commonwealth Government launched the National Small Business Information and Awareness Program and continued the concept of multiplier agencies, but only for accountants, bank managers and solicitors. The idea was that the three professional groups, in liaison with government agencies, would make small business people more:

aware of the need to improve their management skills and to bring to their attention the wide range of readily available management education and training aids prepared by government as well as other public and private sector services. (Beddall Inquiry 1990)

The Beddall Inquiry recommended that further funding be provided for the program, but there has been no subsequent feedback regarding the scheme and its success or otherwise.

Williams (1991) found a positive relationship between superior management skills and small business survival, and the frequency of consultation with external professional advisors and the wideness of the range of advisors used. Nevertheless, 70% of proprietors had made no use of external sources of business advice since starting, and a further 13% sought such advice very infrequently. As in management training, there was a widespread reluctance to admit need and therefore to seek outside help. Williams said there were some commonly quoted reasons for the reluctance:

1. Professional advisers are regarded by small business owner-managers as having training and experience far more suited to large organisations and therefore cannot be empathetic with small enterprises.
2. No outsiders can be expected to really understand the problems of a specific small firm.
3. The cost of consultations is too high.
4. Advisers use jargon.
5. It is difficult to find time for meaningful analysis, and advisers tend to be reluctant to visit the business to see for themselves.

Williams found that of the proprietors who sought advice, 30% did so to accountants, 24% used informal sources, 14% accessed bank managers, 10% used consultants, 10% used trade associations, 10% used government counsellors and 5% accessed solicitors. In terms of the probability of survival, the most effective, ranked in order, were accountants, bank managers, trade associations and consultants.

We now consider the small business advisory role of accountants.

SMALL BUSINESS - ACCOUNTANT INTERFACE

The small business - accountant interface presents an anomaly. On the one hand, the public accountant is the chief external professional adviser to small business:

..... accountants have an ongoing contact with small businesses that put them in an ideal position to act as either an advisory or referral service for small businesses to improve their management skills and profitability. Accountants are in a position to provide advice to small business proprietors as they see the overall financial performance of a business. (Beddall Inquiry 1990)

Public accountants are educated and trained in the financial aspects of business more than any other professional and because of their business networks are well placed to be multiplier agencies. On the other hand, we have seen that a root cause of failure lies with the poor management of the finance function of the small firm including accounting, and the main problem areas of surviving firms are in the financial management sphere. We therefore need to ask what public accountants are doing.

WHAT ARE PUBLIC ACCOUNTANTS DOING?

Holmes and Nicholls (1990) in their text *Small Business and Accounting* reviewed research into the small business - accountant interface and their own large scale 1986 surveys in Sydney, Melbourne and Brisbane of 700 public accountants and 3,780 small firms.

Prior research (1970-90) found some consistent results.

1. The predominant assistance provided by external accountants was in the preparation of taxation returns and annual financial statements (Back 1978, Glen 1980, Irons 1981, Peacock 1985d).
2. Few other services were provided to proprietors. In particular, only a few firms received assistance in planning and budgeting (Fargher 1971, Back 1978, Mirza 1979).
3. The frequency of contact between proprietor and accountant was not clear, and varied from once a year to three to four times a year (Back 1978, Shannon 1985, Street Ryan 1985). The amount of contact seemed to be a function of the extent of taxation and related matters.

Conclusions from the Holmes and Nicholls' research included the following.

1. The primary reason for small firms to engage external accountants was for 'tax advice/return' purposes (87% of respondents) and preparation of statutory accounts (52% of respondents).
2. A significant difference occurred between the volume of accounting information prepared within the firm and that prepared externally by the accountant. A much greater proportion of firms used accountants to provide information for tax returns, statutory financial statements, and annual income statements and balance sheets. The limited accounting completed internally was for other requirements and this led the researchers to comment that:

The majority of owner-managers surveyed primarily seek accounting information for reasons largely unassociated with business decisions the main reason small business owner-managers prepare or acquire accounting information is to meet statutory requirements.

Breen et. al (1994) surveyed 203 Victorian public accountants and found that their workload was apportioned on the average between 69% of hours in tax compliance (58%) and tax planning (11%), 16% in business management advice, 10% in preparation of accounting reports, and 5% in investment advice. *Yellow Pages Australia Small Business Index* (September 1995) found that assistance provided by accountants comprised taxation returns and planning (81% of firms), superannuation planning (46%), cash flow projections / budgets (26%), business strategy / planning (26%) and other (13%). In June 1996 it was found that 78% of firms with less than 5 employees used an accountant only to complete their annual tax returns (Micro Business Networks 1996). In South Australia, Peacock (1997) found that in a sample of small businesses for 1994-95, 72% received only taxation, statutory return compliance and bookkeeping services in contrast to an earlier similar survey in 1984 where the proportion was 64% (Peacock 1984a).

It seems quite clear that the main preoccupation of the public accountant is to provide assistance for, and often to prepare, taxation and statutory accounting returns for small business owner-managers. Accounting information that is provided for the business tends to be used for these returns and not to facilitate the owner-manager's decision-making. Moreover, only limited accounting information is prepared within the business for decision-making. The provision of non-accounting advice is very limited and it appears that the Beddall Inquiry was being optimistic in claiming that '....accountants have an ongoing contact with small businesses' such that they '..... see the overall financial performance of a business.' In the light of the research findings, and given the general lack of financial expertise in many small business proprietors, it is not surprising to find that the small business finance function is inadequately managed, leading to problems and failure.

WHAT COULD PUBLIC ACCOUNTANTS PROVIDE FOR SMALL BUSINESS?

The accountant is the logical person to service the small business finance function. An accounting system, initially basic and quite simple, needs to be developed that provides information to guide decisions and is linked to a tailor-made budget system. Liquidity management should have priority and advice should be

available for acquiring finance and in the allocation of funds. The extent to which the detailed work of accounting and other financial management is actually undertaken by the accountant should vary with the individual firm and its stage of growth.

As soon as possible the firm should carry out its own bookkeeping and complete simplified accounting reports using the latest computing technology. Operating and strategic planning and preparation of business plans should originate with the proprietor, but with guidance from the accountant. As the firm grows it should move towards autonomy in detailed financial management as financial staff are employed, and the external accountant remain in an advisory capacity.

The public accountant has a particularly important role to play in pointing firms to sources of finance, assisting them to prepare proposals for funds and in promoting the investment readiness of growth firms. This will entail networking between accountant, small business owner-manager and banker or other finance provider. The accountant is potentially the best placed and best equipped person to act as multiplier agent or facilitator and to provide a total advisory service which is not restricted to accounting and other aspects of the finance function. Some accounting firms already provide services in areas such as industrial relations, legal matters, secretarial practice, personal finance, and succession planning. However all accountants can facilitate referrals to other professionals, other advisory services, government agencies and private organisations that can provide what is required for managing the small business.

The traditional accountant is usually pictured as being the impersonal provider and creator of information of a narrow financial nature - the 'history maker, recorder and doom-sayer' (Marsh 1988). However, the traditional small business owner-manager, as we have already seen, "is the business", with a significant emotional attachment to their venture. The strategic decision-making process in a small business can only be understood if the business is regarded as a learning organisation in which many owner-managers are as much concerned with personal and family non-profit goals as with long-term profitability. Problems and failure that may be recorded in official statistics or by researchers as resulting in financial loss may have as much to do with the competing demands of personal/family interests as with the finance function.

The accountant therefore needs to be a proactive stakeholder in the firm, concerned with understanding the owner and communicating with them, in order to provide business advice - 'a dream accountant working alongside as an adviser, consultant and business helper' (Marsh 1988). According to Leslie et. al (1985) there is a 'much neglected aspect of small business failure':

..... much of the literature, in pointing the finger solely at the person in small business, has been neither fair nor helpful. We would like, therefore, to shift the focus onto the adequacy of the transactions which occur between those in small business and their financial advisors.

Rather than being peripheral to the small business, a more desirable situation for both small business and external accountant, is one in which the accountant becomes central to the business. Because of their specialised training the accountant should provide well rounded financial advice to the proprietor for the servicing of the finance function, which includes relevant accounting. Where needed, specialised financial advice may need to be provided by referral e.g. import/export advice, valuations and information regarding business angels.

The accountant, being attuned to all the needs of the enterprise, will provide non financial advice directly or by referral. In some cases, such advice will be complementary to financial advice e.g. if a new product range is planned, market advice may be needed as well as funding advice. One medium size Adelaide accounting firm stresses its ability to provide involvement in all material business decisions of small business clients:

*..... our people have gained considerable hands-on experience with day-to-day decision making and negotiating. However, if we are unable to solve your problems, or give you confident professional advice, we will refer you to leading professionals sharing a relationship with us. We can seek clarification of queries, and will confidently refer our clients to respected:
solicitors land brokers insurance brokers finance brokers land and business agents
licensed investment advisers the right banks and bank managers.*

When required, we will assist clients by arranging and attending meetings with these professional colleagues, ensuring a continuity of advice and the coordination of services. By using our connections, clients can have confidence in the impartiality and competence of consultants in every field.

WHAT ARE THE PROBLEMS?

When accountants have been asked why they could not provide advisory services in addition to taxation and compliance services there have been some standard reasons provided, and equally standard responses can be made to them (Back 1981, Cohen 1987, Flavel 1989).

- 'I don't have time.'

For some accounting practices this is true.

Response: It is the causes of a lack of time that are relevant. Some practices have a very high ratio of clients per partner/principal and a reluctance apparently to recruit more experienced staff. The more common reason is a preoccupation with taxation and conformance reporting matters.

..... evidence was presented that accountants have to spend so much time dealing with the complexity of taxation requirements that they are unable to devote sufficient time to giving management advice to their small business clients. (Beddall Inquiry 1990)

- 'Clients don't want advice on anything other than tax.'

Response: Only partly true, and only an assumption for accountants who have failed to market a total product to their small business clients.

- 'Clients come to us too late.'

Response: True for some clients, but is it really all their fault?

The more likely problems causing the inefficient small business - accountant interface lie in three areas.

1. Costs versus benefits.

It could be that proprietors are not convinced that external managerial services are cost-beneficial; after all, they are in business and know that value should be provided for price. Holmes and Nicholls (1990) found however that 67% of small firms felt that information currently provided by accountants 'always' or 'usually' justified the cost. Also, accounting costs were a small proportion of their total business expenses e.g. 1.8% for firms with 1 - 10 employees. When accountants were asked whether their small business clients would pay more for management advice than compliance work, 64% said 'yes'.

A. Cameron (1995) investigated public accountancy fees in New Zealand and based on his findings, and his knowledge of Australian accountants, said:

With respect to compliance services....., small business and third parties perceive these services to be cost-beneficial. Accountants can therefore be satisfied that they are perceived to be efficiently fulfilling their traditional role.

..... public accountants must make a greater effort to ensure, and then demonstrate, that their business advisory services are cost-beneficial(they) should provide more justification for the level of fees charged, including information about the complexities of the work they do and the way in which the bills are calculated.

The question may equally be asked as to whether accountants find that non-compliance/tax work is profitable for them. Breen et. al (1994) found from Victorian accountants that “management advice” and “compliance work” were equally profitable based on an hourly rate, and also there was a direct relationship between the profitability of these two areas and the proportion of total workload devoted to them.

2. Perception gap.

Holmes and Nicholls asked small business owner-managers ‘what other professional services are you aware your external accountant could provide, if required?’ Only 32% responded - of these, 38% said ‘nothing’ or ‘don’t know’, and the remainder gave a very restricted range of services. By contrast, accountants listed a much wider range of services including business planning, management accounting, investment advice, computer facilities, estate planning and employee selection/training. There was a ‘significant difference between the perception of owner-managers of the services available and the services actually available.’

Leslie et. al (1985) agreed that there was a perception gap regarding what accountants could offer to small firms:

We feel that the often heard response that - ‘if the client comes in for a tax return then that’s all he/she wants’ - is not a legitimate one. It presupposes that the client is aware of all their needs and of the services available and has made an informed choice. This, in most cases, is patently not the case. If a similar argument were advanced by a doctor it would be dismissed out of hand.

Flavel (1989) agrees with Leslie et. al that the perception gap between accountant and small business is not just about services that may be available, but also that many proprietors simply do not know what to ask for. Holmes and Kelly (1988) implied that accountants’ services may not be taken up by small business clients because they ‘lack the necessary skills to use, interpret and utilise (accounting) information.’ Flavel’s response was that although many proprietors are financially illiterate, it remains critical that they be acquainted by their accountants with basic tasks and tools such as aged debtor’s controls, simple single entry bookkeeping systems and a few financial ratios. Accountants would provide a more useful service by doing this than stressing the traditional historical end-of-year income statement and balance sheet, which cannot be used to “drive” the business.

3. Capacity of accountants.

Much stress is placed on the lack of financial expertise of many small business owner-managers in contrast to the accountant (and other professionals), educated and trained in financial matters. What is being overlooked is the actual capacity of the public accountant to be a central stakeholder in a small firm and not just a tax/compliance “factory.” Nearly 20 years ago, Back (1981) told the South Australian Congress of the Institute of Chartered Accountants that many public accountants lacked the training and the expertise to act as small business facilitators. His contention was that although accountants, and many other professionals, were educated and skilled in their financial/accounting disciplines they were quite ignorant of the small business culture, did not know how to communicate with and assist small business proprietors, and many had no wish to do so except for mechanical taxation work.

Leslie et. al (1985) believed that little had changed in their article in *The Australian Accountant*. Accountants’ tertiary education and subsequent professional training had not provided public accountants with an understanding of the uniqueness of small firms and their owners, the need for communication and diagnostic skills in providing services, and the need to perform ‘a number of roles including counsellor, father-confessor, bully, provider of emotional support and often, scapegoat.’

G. Cohen, past president of the Institute of Chartered Accountants, said in 1987 that a major reason for the reluctance of public accountants to provide business advice was ‘Due to their limited business experience and training.....’ In 1994, T. Boreham said:

Clearly small to medium-sized enterprises are crying out for assistance when it comes to management advisory services, but unfortunately there are not enough trained or qualified small to medium enterprise advisers in the accountants’ ranks.

B. Charles (1995), writing in the *Australian Accountant*, quoted an accountant who said:
Our professional studies give no such advice (education in business planning) on handling small to medium enterprises. We did not get it at academic levels.

Following a university degree, graduates become full members of the Institute of Chartered Accountants (ICA) or the Australian Society of Certified Practising Accountants (ASCPA) when they have passed further in-house professional studies. Studies in small business have never been mandatory in either the university courses or the subsequent professional subjects. Only very recently has one elective small business subject become available in the professional studies, but they are predominantly technical in nature and hardly touch the unique characteristics of the small business and the owner-manager.

Summary

There is no doubt that there is a proportion of accounting practices which will remain entrenched in taxation/compliance services to the extent that competition allows them to do so. There is also a proportion which is already successfully and profitably engaged in the provision of full advisory services to small firms. Key reasons why many of the remainder do not provide a holistic service to the small business sector in Australia lie with the perception gap between provider and client, and the fact that many professionals lack an appreciation of the small business discipline and its relation to general business education and training.

SOLUTIONS

What solutions can be suggested to improve the small business - accountant interface? On the small business side, there is an unsatisfied need for advisory services especially in financial matters. The need cannot be quantified, but is evidenced by the fact that inefficient financial management is the chief root cause of failure and that financial matters are the no. 1 problem area for surviving small firms. On the accountants' side, there is a large, again unquantified, proportion of accounting practices which could potentially meet the need.

Many small businesses are unaware of their need and do not know what to ask for. This is part of the larger small business problem of a lack of business and management education and subsequent management training. The long term solution suggested by the Beddall Inquiry was that people receive business/management education/training at schools and other educational institutions before commencing employment, whether in small business or elsewhere. The Karpin Inquiry agreed, as part of establishing a positive enterprise culture in Australia. Universities have an important role to play - see appendix 10A. For the present small firms, commentators tend to agree that the onus is on providers/trainers of education and training to become proactive in marketing relevant products to small business clients. Meanwhile, because many small businesses remain ignorant of their need, responsibility remains with the other side of the interface, the accounting profession.

Back (1981) and subsequent commentators have been concerned about the attitude of the top ranks of the accounting profession towards small business, the provision of advisory services to small firms, and the consequent direction of policy to members of the profession. At the best it has been laissez faire, although in more recent years a more positive attitude has appeared. There is now one small business elective in professional studies and more electives within continuing professional development, but few university graduates enter the profession having studied the small business discipline. A radical reform is needed by the profession so that more public accountants become equipped to work with small businesses (Gibson 1988).

A broader reform of current practice will be achieved if a small business management focus is included in pre-practitioner education and training programs. This would mean the inclusion of a mandatory small business management topic within the undergraduate education program for accountants. It would also involve increased attention to small business issues in the Professional Year and CPA programs to ensure

that all new public practitioners receive appropriate professional training prior to gaining practising certificates. (Breen et. al 1994)

The perception gap needs to be breached by accountants and this requires proactivity, starting with the top management of the profession. Accountants, as suppliers, need to market their product to their small business clients. As with training providers, they need to adopt marketing techniques that start with the premise that their clients are unaware of what is on offer and what they really need. Accountants are not noted for their marketing abilities, so this is a substantial challenge.

The most positive aspect of the small business - accountant interface, found in Victoria by Breen et. al, is that younger accountants and those involved in more recently established practices are more disposed towards change and the provision of management services. The profession, in addition to a general change in attitude, needs to particularly target newer accountants.

SUMMARY

There is a high failure rate of small business in Australia although there are various meanings of "failure" and disagreement on the actual rate. Even though resource poverty affects all small businesses in differing degrees, the root cause of failure is management inefficiency and particularly inefficient financial management and poor accounting.

The four main assistance areas needed are in start up preparation, business and management education, management training and advisory services. Because of a reluctance of many small business proprietors to apply self-help in these areas, government policy is directed towards education courses containing business and management subjects and an understanding of small business. Universities have an important role to play in this regard.

Although public accountants are the main professional advisers to small business, the small business - accountant interface is an inefficient one. Solutions are not easy, but a key one is that the accounting profession ensure that a requirement for accountants to enter the profession is that they be educated and trained in the small business discipline.

NOTES

Included in a submission from the Bureau of Industry Economics.

1. Within a limited official classification, reasons for bankruptcies are published for the public, but information regarding liquidations needs to be accessed from legal files.
2. Pattinson and Tozer (1997) used ABS data for 1994-95 and 1995-96 and found an exit rate of 7.7% for firms with 1-19 employees in contrast to 5.4% for firms with 20 or more employees.
3. Watson and Everett (1993) is acknowledged as the source of much of this information.
4. According to Reynolds et. al (1994) there is evidence of an increasing number of early failures in later years of the study.
5. The researchers also obtained similar information for "Prevent further losses" (2.3% average failure rate) and "Discontinuance of ownership (11% average failure rate).
6. It is also possible that a greater proportion of franchisees operate within managed shopping centres than within the overall small business sector, and this could affect the sampled failure rates.

7. For the 1983 survey, 66% of references related to financial management and for 1994, 39%.
8. This writer has varied the grouping. "Accounting" includes "poor books and records" (12.26%), plus "inability to use/understand financial reports and statements" (3.94%) transferred from "Financial management ...". Also, "Employment relations" comprises "staffing problems" (9.03%) plus "union problems and 'interference'" (6.19%).
9. There are a number of limitations in using these bankruptcy statistics in relation to small business failures. They relate to individuals only but several bankruptcies may result from a single business failure. Importantly, causes of failure are self-attributed and subsequently are classified from information provided by the bankrupts themselves.
10. In later years of the sample the proportion of tertiary-qualified owners had increased.
11. Respondents were asked to rank the sources as "excellent", "average" and "poor". Only the "excellent" responses are summarised here.
12. Other advisory services included the Australian Tax Office 23%, office machinery and equipment suppliers 20%, business associations 15%, business consultants/lecturers 9%, and the ABS 4%.

REFERENCES

- Advertiser*, "Small Business Problems" (July 13 1985), p. 23.
- 1996-97 *Annual Report by the Attorney-General on the Operation of the Bankruptcy Act 1966* (Canberra: AGPS 1997).
- ABS Cat. 8127.0, *Characteristics of Small Business Australia 1995, 1997* (Canberra: AGPS 1996, 1998).
- Australian Society of Certified Practising Accountants, *Handling Your Bank: A Small Business Perspective* (Melbourne: ASCPA 1994).
- _____, <http://www.cpaonline.com.au/>
- R. D. Back, *The Practising Accountant in Queensland as an Adviser to Small Firms*, Department of Commerce paper (Townsville: James Cook University, 1978).
- _____, "The Practising Accountant as an Adviser to Small Business", *Accounting Forum* 4 (1981), pp. 56 - 59.
- _____, *Success in Small Business. The Role of the Financial Adviser* (Sydney: Longman Professional & Institute of Chartered Accountants, 1985).
- J. E. Berryman, "Small Business Failure and Bankruptcy: A Survey of the Literature", *International Small Business Journal* 1 (1983), pp. 47 - 59.
- _____, "Small Business Failure and Bankruptcy: What Progress has Been Made in a Decade?" *Small Enterprise Research* 2 (1994), pp. 5 - 27.
- T. Boreham, "What Small Business Clients Think of Their Accountants", *Business Review Weekly* (June 27 1994), pp. 98 - 100.
- J. Breen and J. Hall, "Training Needs of Small Business" in K. M. Renfrew and C. McCosker (eds.), *Conference Series no. 17* (Newcastle: University of Newcastle 1990), pp. 91 - 114.
- _____, T. Wilmshurst and C. Calvert, *Accounting Services To Small Business: The Accountants' Perspective* (Melbourne: Victoria University of Technology, March 1994).
- Bureau of Industry Economics, *Small Business Review 1984* (Canberra: AGPS 1985).
- R. Callus, J. Kitay and P. Sutcliffe, "Industrial Relations at Small Business Workplaces", in Bureau of Industry Economics, *Small Business Review 1992* (Canberra: AGPS, 1992), pp. 106 - 138.
- A. Cameron, "Public Accountants' Fees and Small Business Clients", *Accounting Forum* 19 (1995), pp. 13 - 28.
- B. Charles, "Business Planning - A Fresh Field for Accountants", *Australian Accountant* (September 1995), pp. 31 - 34.
- M. Christie, "Self-Directed Learning for Enterprise Education and Training", *Small Enterprise Research* 1 (1992), pp. 5 - 11.

- B. Churchill, "Survival Patterns of the Postwar Business Population", *Survey of Current Business* (1952), pp. 12 - 19.
- A. B. Cochrane, "Small Business Mortality Rates: A Review of the Literature", *Journal of Small Business Management* 19 (1981), PP. 50 - 59.
- G. Cohen, "Accountants and Small Business - A Disturbing Picture", *The Chartered Accountant in Australia* (November 1987), pp. 3 - 5.
- T. Cohn and R. A. Lindberg, *Survival and Growth Management Strategies for the Small Firm* (NY: AMACOM 1974).
- J. Cover, *Business and Personal Failure and Re-adjustment in Chicago* (Chicago: University of Chicago Press 1933).
- J. Curran and J. Stanworth, "Education and Training for Enterprise: Some Problems of Classification, Evaluation, Policy and Research", *International Small Business Journal* 7 (1989), pp. 11 - 22.
- Department of Trade and Industry, *Report of the Committee on Small Business, June 1971* (Canberra: AGPS, 1974). (Wiltshire Inquiry)
- J. W. English, *How to Organise and Manage a Small Business in Australia* (St. Leonards, NSW: Allen & Unwin, 6/e 1995).
- J. Everett and J. Watson, "Systematic and Unsystematic Risk in Small Business Enterprises", in K. M. Renfrew, B. Gibson, P. J. Hutchinson and S. K. Holmes (eds.), *Conference Series no. 21* (Newcastle: University of Newcastle, 1993), pp. 99 - 114.
- K. Fargher, *Problems of Small Manufacturing Businesses in Australia, PhD Thesis* (Sydney: University of NSW, 1971).
- R. Flavel, "The Provision of Accounting Services to Small Business Clients", *Accounting Forum* 12 (1989), pp. 65 - 73.
- F. Friedlander and H. Pickle, "Components of Effectiveness in Small Organisations", *Administrative Science Quarterly* 13 (1968), pp. 289 - 304.
- M. Gallagher, "Building a Small Business Training Strategy - Further Research Challenges", Bureau of Industry Economics, Working Paper no. 71 (Canberra: AGPS, September 1991).
- B. Gibson, "Servicing Small Business: An Accountant's Perspective", *Accounting Forum* 11 (1988), pp. 69 - 81.
- W. Glen, *Information Generation in the Small Business Enterprise, PhD Thesis* (Armidale: University of New England, 1980).
- A. Gome, "Strife-racked Life is Worth a Book," *Business Review Weekly* (October 9 1995), p. 76.
- L. Greiner, "Evaluation and Revolution as Organisations Grow", *Harvard Business Review* 50 (1972).
- D. E. Gumpert and D. P. Boyd, "The Loneliness of the Small Business Owner", *Harvard Business Review* (1984), pp. 18 - 24.
- L. Hailey, "Client Services: Strategy for Success", *Australian Accountant* (March 1997), pp. 45 - 46.
- J. Haswell and S. Holmes, "Estimating the Small Business Failure Rate: A Reappraisal", *Journal of Small Business Management* 27 (1989), pp. 69 - 74.
- T. Hill, *Small Business Production / Operations Management* (Basingstoke: Macmillan, 1987).
- S. Holmes and G. Kelly, "The Provision of Accounting Services to Small Business Clients: The Criticisms in Perspective", *Accounting Forum* 11 (1988), pp. 61 - 67.
- _____ and D. Nicholls, *Small Business and Accounting* (Sydney: Allen & Unwin, 1990).
- Industry Commission and Department of Industry, Science and Tourism, *A Portrait of Australian Business* (Canberra: AGPS, 1997).
- Industry Taskforce on Leadership and Management Skills, *Enterprising Nation: Renewing Australia's Managers to Meet the Challenge of the Asia-Pacific Century* (Canberra: AGPS, 1995). (Karpin Inquiry)
- Institute of Chartered Accountants in Australia, <http://www.icaa.org.au/>
- R. Irons, "Small Business Management and the Advisory role of Accountants", *Accounting Forum* 4 (1981), pp. 44 - 59.
- P. L. Jennings and G. Beaver, "The Management Dimension of Small Business Failure", *Journal of Strategic Change* 4 (1995), pp. 185 - 200.
- D. Keeble, "Small Firms, New Firms and Uneven Regional Development in the United Kingdom", *Area* 22 (1990), pp. 234-245.
- R. Langford, "Are Too Many People Minding Their Own Business?" *Business Review Weekly* (February 24 1997), pp. 76 - 77.

- M. Leslie, G. Magdulski and N. Champion, "The Role of the Accountant in the Survival of Small Business", *The Australian Accountant* (January - February 1985), pp. 22 - 30.
- J. Lowe, J. McKenna and G. Tibbits, "Small Firm Growth and Failure: Public Policy Issues and Practical Problems", in K. M. Renfrew and R. D. Back (eds.), *Conference Series no. 17* (Newcastle: University of Newcastle 1990), pp. 175 - 190.
- C. Maguire and R. Kench, *Information and the Small Manufacturer*, School of Librarianship (Sydney: University of NSW, 1974).
- W. Marsh, "The Magic Mix of Marketing", *Australian Accountant* (March 1988), pp. 26 - 29.
- R. G. P. McMahon, S. Holmes, P. J. Hutchinson and D. M. Forsaith, *Small Enterprise Financial Management: Theory and Practice* (Sydney: Harcourt Brace, 1993).
- Micro Business Network Survey, June 1996.
- A. M. Mirza, "Budgeting: A Versatile Management Tool for Small Business", *The Chartered Accountant in Australia* (August 1979), pp. 61 - 62.
- A. Morehead, M. Steele, M. Alexander, K. Stephen and L. Duffie, *Changes at Work: The 1995 Australian Workplace Industry Relations Survey* (Sydney: Longman, 1997).
- M. Newell, "Government's Awareness Policy Should Start in Canberra", *Advertiser* (June 10 1988), p. 47.
- B. Pattinson and C. Tozer, *Occasional Paper. Business Exits Australia 1994-95 and 1995-96*, ABS Cat. 8144.0 (Canberra: AGPS, 1997).
- R. Peacock, "Small Business in the Adelaide Metropolitan Area: A Survey", *Small Enterprise Series no. 1* (October 1984a).
- _____, "Small Business Mortality: Legal Failures in South Australia" *Small Enterprise Series no. 4* (December 1984b).
- _____, "Small Business Mortality: Annotated Bibliography", *Small Enterprise Series no. 3* (December 1984c).
- _____, "The Financial Effects of the Legal Failure of Proprietary Companies", *Accounting Forum 8* (March 1985a), pp. 25 - 33.
- _____, "Corporate Failure - Effects and Causes", *Professional Administrator* (October - November 1985b), pp. 43 - 55.
- _____, "Finding the Causes of Small Business Failure", *Management Forum 17* (1985c), pp. 77 - 89.
- _____, "The Small Business Finance Function", *Australian Accountant* (January - February 1985d), pp. 42 - 48.
- _____, "The Effects of Business Bankruptcies", *Credit Review* (June - July 1986), pp. 10 - 15.
- _____, "Small Business in South Australia: 1985 Survey Part 1", *Small Enterprise Series no. 6* (May 1987).
- _____, A. Palmiero and A. Spatharos, "Small Business Mortality: Business Bankruptcies in South Australia", *Small Enterprise Series no. 5* (April 1988).
- _____, "Bankers and Business Plans", *Accounting Forum 13* (1990), pp. 54 - 58.
- _____, "Small Business in South Australia: A Snapshot", *Small Enterprise Series no. 32* (March 1997).
- C. Perry and W. Pendelton, *Successful Small Business Management* (Sydney: Pitman Publishing, 1983).
- R. A. Price, *Small Business Management for Small Business Owner-Managers* (Melbourne: Wadsworth International, 1984).
- Small Business in Australia: Challenges, Problems and Opportunities. Report by the House of Representatives Standing Committee on Industry, Science and Technology* (Canberra: AGPS, 1990). (Beddall Inquiry).
- W. Reynolds, W. Savage and A. Williams, *Your Own Business. A Practical Guide to Success* (Melbourne: ITP Thomas Nelson, 2/e 1994).
- P. Roberts, "Business Expansion: Now There's a Capital Idea", *Financial Review* (April 7 1994), p. 2.
- M. Scott and J. Lewis, "Re-thinking Entrepreneurial Failure" in J. Lewis, J. Stanworth and A. Gibb (eds.), *Success and Failure in Small Business* (London: Gower, 1984), pp. 29 - 56.
- R. P. Shannon, *An Evaluation of the Role of the Practising Accountant Providing Management Advisory Services to Small Business Clients in the North-West Region of New South Wales*, *MEc Thesis* (Armidale: University of New England, 1985).
- N. Sorby-Adams, "Business Failures Among Small Proprietary Limited Companies", *Management Forum* (1981), pp. 255 - 264.

- J. Stanworth and C. Gray, "Entrepreneurship and Education: Action-based Research with Training Policy Implications in Britain", *International Small Business Journal* 10 (1992), pp. 11 - 23.
- A. Star and M. Massel, "Survival Rates for Retailers", *Journal of Retailing* 57 (1981), pp. 87 - 99.
- D. J. Storey, K. Keasey, R. Watson and P. Wyncarczyk, *The Performance of Small Firms* (London: Croom Helm, 1987).
- D. J. Storey, *Understanding the Small Business Sector* (London: Routledge, 1994).
- _____, "Symposium on Harrison's 'Lean and Mean': A Job Generation Perspective", *Small Business Economics* 7 (1995), pp. 337 - 340.
- Street Ryan & Associates, *Small Business Training and Assistance in the Goulburn Valley Economic Region* (Shepparton: Goulburn Valley Region Development Board, 1985).
- Temporary National Economic Committee, *Problems of Small Business*, Monograph no. 17 (Washington: Government Printing Office, 1941).
- T. A. Ulrich and G. S. Cole, "Towards More Efficient Training of Future Entrepreneurs", *Journal of Small Business Management* 25 (1987), pp. 32 - 39.
- J. Watson and J. Everett, "Defining Small Business Failure", *International Small Business Journal* 11 (1993), pp. 35 - 48.
- _____, "Do Small Businesses Have a Higher Failure Rate?" in W. Dunlop and B. Gibson (eds.), *Conference Series no. 23* (Newcastle: University of Newcastle, 1995), pp. 331 - 345.
- _____, "Do Small Businesses Have High Failure Rates?" *Journal of Small Business Management* 34 (1996), pp. 45 - 62.
- _____, "Small Business Failure Rates: Choice of Definition and the Size Effect", *Entrepreneurial and Small Business Finance* 5 (1998), pp. 271-285.
- J. A. Welsh and J. F. White, "A Small Business is Not a Little Big Business", *Harvard Business Review* 59 (1981), pp. 18 - 30.
- A. J. Williams, "Why So Many Small Businesses Fail", *Real Estate Journal* (1975), pp. 16 - 18, 22.
- _____, "A Longitudinal Analysis of the Characteristics and Performance of Small business in Australia", in K. M. Renfrew and R. D. Back (eds.), *Conference Series no. 14* (Newcastle: University of Newcastle, 1986), pp. 201 - 258.
- _____, *The Characteristics and Performance of Small Business in Australia (1973 to 1985), Report Prepared for the Department of Industry, Technology and Commerce* (Newcastle: University of Newcastle, 1987).
- _____, "Small Business Survival: The Role of Formal Education, Management Training and Advisory Services" in Bureau of Industry Economics, *Small Business Review 1990-91* (Canberra; AGPS 1991), pp. 43 - 82.
- Yellow Pages Australia Small Business Index*, "A Special Report on Social Issues" (November 1993),
- "A Special Report on Finance and Banking Issues" (September 1995), <http://www.pacificaccess.com.au/sbi/index.html/>

