

## **CHAPTER 1: INTRODUCTION TO THE RESEARCH STUDY**

### **1.1 Introduction**

This thesis presents an original description and analysis of data that has recently become available shedding much needed light on the role more sophisticated financial reporting practices may play in facilitating business growth and performance enhancement amongst smaller enterprises in the Australian manufacturing sector. Predominantly, such concerns are legally organised as proprietary companies. The focus is upon general purpose financial reporting broadly defined to embrace production and use by owner-managers and managerial employees of the balance sheet, the profit and loss statement and the cash-flow statement, prepared from both historical and future-oriented perspectives, for overall financial management of a business concern.

This opening chapter of the thesis first specifies the principal research question addressed by the study, proposes a data source for use in answering the question, defines key terms in the question, and provides an initial justification for posing the question and seeking its answer. Then the increasing significance of smaller enterprises in economic activity is highlighted and explained. The contemporary Australian context of the study is subsequently identified and described, adding substantially to the rationale for undertaking the study. This rationale is grounded in the paucity of prior research in the area and the likely value of the findings to those who seek to study, influence and regulate smaller manufacturing enterprises. There follows a specification of the key objectives of the research stemming from the principal research question; and an overview is provided of the study conducted to meet these objectives. The chapter closes with an outline of this thesis.

Note that, because the empirical investigation underpinning the thesis was conducted in 1995, official statistics quoted in the thesis are predominantly no more recent than for calendar 1995 and/or for the 1994-95 financial year. Given customary delays in the release of official statistics, the figures quoted may nevertheless be the latest available.

### **1.2 The Research Question**

#### **1.2.1 Statement of the Research Question**

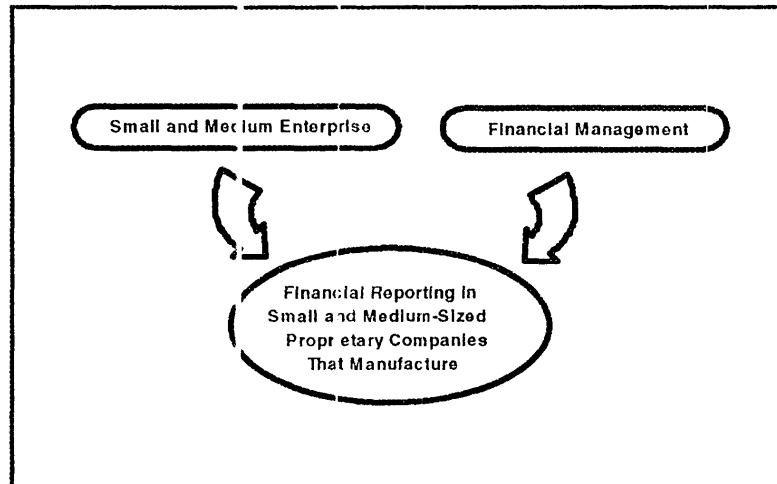
The research described in this thesis draws upon two bodies of scholarship in the broad area of business studies as illustrated in the upper part of Figure 1.1 on the next page. A comprehensive literature search embracing journal, book, conference, thesis and other sources has been carried out. Careful scrutiny of this literature has suggested the following principal research question which, hitherto, has not been explicitly addressed:

Which enterprise and financial management characteristics seem to most influence financial reporting practices adopted in small and medium-sized manufacturing enterprises legally organised as proprietary companies in Australia;

and what impact, if any, do these financial reporting practices appear to have on achieved business growth and performance in such concerns?

The research question should be read in the light of definitions of the intended unit of analysis, business growth and performance, and financial reporting practices presented after the following sub-section of the chapter.

**Figure 1.1: Field of Scholarship for the Research**



### 1.2.2 Addressing the Research Question

A valuable opportunity to address the research question posed above has been provided by the availability, through the federal government's Australian Industrial Property Organisation (AIPO), of data from an Australian Manufacturing Council (AMC) study which led to its publication *Practising Balance: Integrating Best Financial Practice Into Your Business* (Australian Manufacturing Council, 1996). The terms and conditions for use of this data in the present investigation are set out in Appendix A to the thesis.

Research for the *Best Financial Practice* study involved a postal survey in late 1995 of a random sample, stratified disproportionately over enterprise size and manufacturing industry categories, of approximately 5,500 Australian manufacturing enterprises that are predominantly small and medium-sized in employment terms. The survey used a self-administered, structured questionnaire containing over 50 closed questions focused on enterprise characteristics and performance, and financial management characteristics and practices (including financial reporting practices). Responses were received from around 1,800 enterprises, representing a response rate of more than 30 per cent. Over 1,100 responses were from small and medium-sized enterprises with the equivalent of 300 or fewer full-time employees and legally organised as proprietary companies. Ultimately, over 1,000 responses could be used in this research. Some marginal differences exist between the nature of respondents and non-respondents to the survey, but no significant non-response bias was discovered in relation to the financial practices of interest.

This thesis presents an original, comprehensive and insightful description and analysis of data produced by the AMC *Best Financial Practice* study. Justification for using these data rests on four main grounds. First, the AMC survey instrument has yielded (*inter alia*) data which allows financial reporting practices to be adequately described and associated with the circumstances and achievements of responding enterprises. Second, by both national and international smaller enterprise research standards, the AMC study has provided excellent data in terms of sample size and representivity, and the completeness of responses. Underwritten as it was by the Australian federal government a survey of this scale, quality and cost would be difficult indeed for an individual researcher to match. In fact, without the authority of the federal government behind it, it is unlikely that smaller manufacturers in Australia would have responded to such a survey in the numbers they did.

A third reason for using the AMC data in this research is that, because the AMC was wound up by the federal government soon after the study was conducted, description and analysis of the information obtained have been very limited. At the time of completion of this thesis, the only other report on the AMC study known to the present author is the booklet *Practising Balance: Integrating Best Financial Practice Into Your Business* (Australian Manufacturing Council, 1996). This publication is addressed to owner-managers of smaller manufacturing enterprises, is highly prescriptive and, with all due respect to its authors, contains a less than full and essentially naive analysis of the data. While this undoubtedly met the requirements of the AMC at the time, it far from exploits the full scholarly value of the excellent data collected at considerable expense to all concerned. Nor does it inform as fully as it might those who influence and regulate smaller manufacturing enterprises. In other words, the potential of the data as far as its scholarly and policy significance is concerned is far from realised. Extensive enquiries have revealed there is no present plan for the federal government or its agencies to employ the data any more fully than already has been done.

A fourth reason for using the AMC data in this research is that, through the efforts of the federal government's Corporations Law Simplification Task-Force, substantial changes have recently occurred in the Australian law on financial reporting by proprietary companies. The *First Corporate Law Simplification Act 1995* became operative in December, 1995; but, because of teething problems and transitional arrangements, the changes have not been fully implemented until the 1997-98 financial year. Thus, the present research would need to wait until, at least, late 1998 before surveying owner-managers of proprietary companies on their post-simplification financial reporting practices in anything approaching steady-state. Alternatively, an attempt could be made to gather information on their pre-simplification financial reporting practices; but this would necessarily require dependence on recall data with diminished reliability. Fortunately, the postal survey in the AMC's *Best Financial Practice* study was conducted in November, 1995 when proprietary companies would still have

been following pre-simplification financial reporting practices. Thus, use of the AMC survey findings enables a pre-simplification study to be conducted without having to employ recall data. It is worth mentioning that the Corporations Law Simplification Task-Force did not attempt to rigorously benchmark financial reporting practices of proprietary companies before making new law in the area.

This early indication of the use of secondary data is provided to alert the reader to the constraints on and/or limitations to the investigation this necessarily entails. The present author was not involved in collection and organisation of the data, and therefore could not have influenced research choices made by the AMC. Thus, as far as the data is concerned, the obligation throughout the thesis is to critically evaluate the choices already made by the AMC, and to ascertain the likely implications of these for the reliability and the internal and external validity of this research.

### 1.2.3 Defining Terms in the Research Question

#### 1.2.3.1 Smaller Business Enterprises

The unit of analysis in this research is individual small or medium-sized manufacturing enterprises predominantly owned, managed and operated in Australia that could be growing by catering to domestic and/or international markets. The enterprise size, manufacturing, legal organisation and growth dimensions of the unit of analysis are addressed in this and subsequent sub-sections of the chapter.

The *First Annual Report on Small Business in Australia* released by the then Department of Industry, Technology and Commerce (1991, pp. 4-5) employs a definition of small enterprise which embraces any business concern that has the following ownership/management/organisational characteristics:

- It is independently owned.
- It is closely controlled by owner-managers who have primary responsibility for the principal decisions made.
- Its owner-managers contribute most, if not all, of the capital.
- Its operations are usually locally based, although its markets might not be.

This definition has its origins in the House of Representatives Standing Committee on Industry, Science and Technology report entitled *Small Business in Australia: Challenges, Problems and Opportunities* (Beddall, 1990). It has continued in use, in more or less the same form, in subsequent annual reports/reviews presented to the federal parliament on small enterprise in Australia (Department of Industry, Technology and Commerce, 1992; Department of Industry, Technology and Regional Development, 1993; Department of Industry, Science and Technology, 1994, 1995a; Department of Industry, Science and Tourism 1996).

The essentially qualitative definition given in the previous paragraph is supplemented, but not overridden, by quantitative criteria based on employment numbers. For example, it is considered that the characteristics identified above are most

likely to be evident in manufacturing concerns employing fewer than 100 persons, and in non-manufacturing businesses other than those in agriculture, employing fewer than 20 persons. Official statistics collected on small enterprise in Australia by the Australian Bureau of Statistics (1991, 1993a, 1996a) now use these employment benchmarks for non-agricultural small enterprises. An earlier compendium of small enterprise statistics prepared by the Australian Bureau of Statistics (1988) used an employment benchmark of fewer than 20 persons regardless of principal activity, except for agricultural businesses. The Australian Bureau of Statistics (1991, 1993a, 1996a) also identifies and provides statistics on 'very small businesses' defined as generally employing fewer than five persons. In the case of manufacturing, such concerns are held to be those employing fewer than four persons (Australian Bureau of Statistics, 1996a, 1996b, 1996c).

To date, there has not emerged an official Australian definition of medium-sized enterprise which has the same standing as that given above for small enterprise. Peacock (1996) has drawn attention to a lack of definitional clarity, in both quantitative and qualitative terms, for medium-sized enterprises in the research and policy literature; and he notes a paucity of published research focusing specifically on such concerns. Following Bromson (1995) who explores the role of medium-sized enterprises in a globalised environment, Peacock (1996, p. 185) points out that 'A vast majority of articles citing [small and medium-sized enterprise] in their key words in fact focus on small enterprises'.

The most recent compendium of statistics on small enterprise produced by the Australian Bureau of Statistics (1996a) does not give a definition for medium-sized enterprises; nor does it provide separate statistics for such concerns. Medium-sized and large business enterprises (that is, enterprises falling outside the definition of small enterprise used) are treated as a single category. However, the Australian Bureau of Statistics (1993b, 1993c, 1994-1995) has, for several years, published an annual statistical collection entitled *Business Operations and Industry Performance, Australia*. The first edition, which was for 1990-91 (Australian Bureau of Statistics, 1993b, p. 24), uses enterprise size categories based on employment numbers as follows:

*Large business groups* include all management units which are part of a group of related businesses which employs over 600 persons or has income of more than \$250 million.

*Small businesses* are those management units which are not part of large business groups and employ:

- less than 20 persons for non-manufacturing industries; or
- less than 100 persons for manufacturing industries.

*Medium businesses* are those management units which are neither classifiable to large business groups nor to small businesses, according to the above criteria.

A range of financial performance and position measures are reported separately for each of these size categories, along with overall measures for enterprises of all sizes. The collections in this series for 1991-92 (Australian Bureau of Statistics, 1993c) and

1992-93 (Australian Bureau of Statistics, 1994) are similarly presented, but the criteria for large enterprises are changed to over 500 employees or income of more than \$250 million or assets of more than \$1,000 million. The collections for 1993-94 and 1994-95 (Australian Bureau of Statistics, 1995, 1996d) use only two size categories. There are large enterprises that employ over 200 persons or have assets of more than \$200 million; and there are small and medium enterprises that employ fewer than 200 persons and do not have assets of more than \$200 million.

Recent Australian federal government thinking on quantitative criteria corresponding to business enterprise size descriptors is provided by its response to a survey on small and medium enterprises in member countries conducted by the Asia-Pacific Economic Cooperation (APEC) forum secretariat (Asia-Pacific Economic Cooperation, 1994). The response basically adheres to the qualitative and quantitative criteria for small enterprise given earlier; and it gives the upper limit for medium-sized enterprise as being 500 employees. No benchmarks based on annual sales turnover are given, even though member countries were invited to provide such criteria and some other countries did so. However, it is indicated that the Reserve Bank of Australia, which now collects statistics on bank lending to small enterprises, identifies annual sales of less than \$5 million as a suitable criterion for defining small enterprise. Where employment-based definitions of medium-sized manufacturing enterprises are reported to be in use, the upper limits in other APEC forum member countries are as shown in the table below (Asia-Pacific Economic Cooperation, 1994):

**Table 1.1: Upper Employment Limits of SME Definitions**

<b>Country</b>	<b>Full-Time Employees</b>
<b>Brunei</b>	100
<b>Canada</b>	499
<b>Hong Kong</b>	99
<b>Japan</b>	300
<b>Republic of Korea</b>	300
<b>Mexico</b>	250
<b>Philippines</b>	199
<b>Singapore</b>	100
<b>Thailand</b>	200
<b>United States of America</b>	499

Note that a number of smaller countries (5 of 10 countries in the table) have effectively set an upper employment limit for medium-sized enterprises in the range 200 to 300.

In a preliminary release of results from the Australian federal government's 1995 Business Longitudinal Survey of employing businesses, the Australian Bureau of Statistics (1996e) uses an upper employment limit of 200 persons for medium-sized businesses. Curiously, the boundary between small and medium-sized businesses is set at just 20 employees regardless of principal activity – an upper benchmark level for small enterprise effectively abandoned after publication of the federal government's first official compendium of small business statistics for Australia (Australian Bureau of Statistics, 1988).

On definitions of medium-sized enterprise used internationally, the Bureau of Industry Economics (1992, p. 75) comments as follows:

Also, in many countries, the sphere of small business policy concern has broadened over the past several years to include medium-sized enterprises. As with small business, there is no consistent definition of medium sized businesses although the OECD defines medium sized enterprises as those with 100 to 499 employees.

Recent reports to the Australian federal government which consider aspects of small and medium enterprise such as management education and training (Carmichael, 1994; Karpin, 1995) provide further examples of enterprise size definitions in use. In the main, the prevailing criteria for small enterprise seem to be accepted; but the criteria used for medium-sized business enterprises show considerable diversity.

To summarise the discussion thus far, while overwhelming support can be found for using a lower employment limit of 100 for medium-sized manufacturing enterprises, there is considerable diversity between countries as far as an upper limit is concerned. In the case of Australia, this is even so between agencies within the country and over time within particular agencies. While 500 is the highest upper limit discovered, there seems to be considerable support for an upper limit in the range 200 to 300, especially in smaller economies. Notwithstanding the federal government's recent move to using 500 employees to accord with the OECD definition, and probably on the grounds that Australia well qualifies as a smaller economy, the AMC *Best Financial Practice* study effectively chose to use 300 employees as its upper limit for medium-sized manufacturers. The AMC did survey and receive responses from businesses with more than 300 employees, but in the data file these are all grouped as 'Over 300' – making it impossible to use the 500 employee upper limit with the AMC data. As the preceding discussion has attempted to show, the use of 300 employees is not without precedent; nor does it seem inappropriate for this research.

In the remainder of the thesis, the adjective 'smaller' is frequently used to describe business concerns which more accurately, but less succinctly, might be described as 'small and medium-sized' or 'small and medium' enterprises – commonly abbreviated to 'SMEs'. Any of these terms can be broadly construed to mean owner-managed business enterprises with, at most, the equivalent of 300 full-time employees.

Those with up to 100 employees are considered to be small, with the remainder being designated as medium-sized. Statistics indicating the significance of smaller enterprises in the Australian economy will be presented later in this chapter.

### 1.2.3.2 Smaller Manufacturing Enterprises

Given the unit of analysis in this research, it is necessary to specify what is meant by a business enterprise engaging in manufacturing activities. Horngren *et al.* (1994, p. 35), the seminal management accounting textbook with a well-established reputation internationally, provides a simple definition of manufacturing enterprise as follows:

Manufacturing-sector companies provide to their customers tangible products that have been converted to a different basic form from the materials purchased from suppliers.

An inquiry made of the Australian Manufacturing Council before its winding up established that it had not chosen to develop an explicit definition of what is considered to be a manufacturing enterprise in the Australian context.

For the purposes of statistical collections, the Australian Bureau of Statistics (ABS) (1993d, p. 47) now employs the Australian and New Zealand Standard Industrial Classification (ANZSIC), Division C of which relates to manufacturing and defines this principal activity in the following terms:

This Division includes all units mainly engaged in manufacturing. In a broad sense manufacturing relates to the physical or chemical transformation of materials or components into new products, whether the work is performed by power driven machines or by hand.

In general the manufacture of parts or components is a primary activity of the same class as the manufacture of the finished product except where the manufacture of parts or components is specifically shown as a primary activity of another class.

This definition is acceptable for the purposes of the present research, recognising that there may be some ambiguity regarding the interpretation of 'mainly engaged in manufacturing' and the status of parts and components.

Thus, a smaller enterprise is considered to be engaged in manufacturing if it would be officially classified, on the basis of its predominant activity, as belonging to Division C of the ANZSIC. Because, at the time, the ABS was unable to provide population data for the ANZSIC, the AMC *Best Financial Practice* study used its predecessor schema, the Australian Standard Industrial Classification (ASIC) (Australian Bureau of Statistics, 1983), in designing a random sample of manufacturers, stratified disproportionately over enterprise size and manufacturing industry categories using the ABS's Business Register, to describe the population. However, in the survey instrument, respondents are asked to classify their enterprises according to ANZSIC Division C codes. Statistics indicating the significance of smaller manufacturing enterprises in the Australian economy are presented later in this chapter.



### 1.2.3.3 Smaller Growth Enterprises

The principal research question for this study clearly focuses attention on SME growth and development. For the purposes of this study, reliance is placed upon the following broad definition of smaller growth enterprise adopted by McMahon *et al.* (1993a, p. 15):

In general terms, a smaller growth enterprise is considered to be an owner-managed concern experiencing on-going, significant and often rapid increases in some or all of the usual indicators of size such as sales revenues, assets, profits (possibly) and number of employees; and which may also be moving towards greater product, geographical or technological diversity.

Over the last decades or so in particular, smaller enterprises of this type have received considerable attention from researchers and policy-makers for reasons identified by Turok (1991, p. 29) as follows:

There is considerable interest within the field of small firms policy and research in the identification of features that distinguish firms which grow from those that stand still or fail. This is thought important if more selective small firms policies are to be developed. Identifying distinctive features of more and less successful firms may also provide insights into the factors influencing small firm development and hence improve understanding of the growth process.

Gibb & Davies (1989, 1990, 1991) give a fuller account of the research and policy imperatives for 'picking winners' amongst small and medium-sized enterprises world-wide.

The emphasis in the present research is upon internally-generated growth through development and expansion of a business's financial, physical and human resources, product or service lines, target markets and customer bases, geographical spread of facilities and markets, etc. The internal growth focus of this study is enabled by the inclusion of several questions in the survey instrument for the AMC *Best Financial Practice* study which seek information on the internal growth orientation, aspirations and achievements of respondents.

Some indication of the significance of Australian businesses with growth aspirations in the year of data collection for the present study is provided by the results of the federal government's 1995 Business Longitudinal Survey of employing businesses of various sizes shown in Table 1.2 on the next page (Industry Commission & Department of Industry, Science and Tourism, 1997). These figures suggest that growth aspirations increase with enterprise size; and that growth aspirations are higher for manufacturing concerns than for businesses across all industries. It would appear that the smaller growth enterprises of interest to this research amount to, at most, 30 to 40 per cent of the population of smaller manufacturing businesses. More detailed consideration of the meaning and significance of smaller enterprise growth is presented in Chapter 2 of the thesis.

### 1.2.3.4 Smaller Enterprise Growth and Performance

Most simply, growth could be said to have taken place if a small or medium-sized enterprise is perceived to have moved from one stage of development to the next in some business life-cycle mode. Stemming from the definitions of smaller business

**Table 1.2: Growth Aspirations of Australian Businesses, 1995**

<b>Size Range (number of employees)</b>	<b>Intending to Significantly Increase Production Levels (per cent)</b>	<b>Intending to Maintain Existing Production Levels (per cent)</b>	<b>Intending to Significantly Decrease Production Levels (per cent)</b>
<b>1 to 4</b>	20.8	40.0	2.8
<b>5 to 9</b>	25.7	38.7	2.3
<b>10 to 19</b>	29.5	41.2	1.4
<b>20 to 49</b>	34.7	36.0	3.4
<b>50 to 99</b>	39.1	26.0	1.6
<b>100 to 199</b>	42.9	24.6	1.1
<b>200 to 499</b>	41.4	20.4	2.2
<b>Over 500</b>	46.4	28.8	1.2
<b>All Businesses</b>	23.8	39.3	2.6
<b>All Manufacturing</b>	38.3	47.5	2.8

enterprise and smaller growth enterprise specified earlier, growth can more definitively be considered to have occurred if either or both of the following specific conditions are met:

- Customary measures of business enterprise size such as employment, sales revenues or turnover, either fixed or total assets, paid-up capital, net profit, retained earnings, and shareholders' funds or net worth have increased in amount from one period to another. Simple or compound rates of increase in such measures over a prescribed period, possibly annualised, provide convenient means of operationalising growth in this sense. Alternatively, basic indications that some measures of enterprise size have increased, remained steady or decreased over a period may need to be used because more exact data are not available, or are considered confidential.
- Relevant dimensions of business enterprise diversity such as products or services supplied, customers served, physical facilities and locations established, processing or value-chain stages undertaken, hierarchical levels and functional

specialisations created, technologies employed, and end-use or geographical markets targeted have increased in number or range from one period to another. Counts on such dimensions, possibly using weightings for the relative importance of items, provide convenient means of operationalising growth in this sense.

It is possible to measure business enterprise performance in two broad senses – financial and non-financial – both of which may be important in smaller concerns. Financial performance measures include key monetary amounts, percentages and ratios which are widely known. Relative measures such as gross margin or return on owners equity are likely to be more useful in assessing financial performance than absolute measures such as sales revenues or net profit. Given that owner-managers of smaller enterprises are frequently reluctant to divulge financial information on their businesses, and also that financial information for such concerns is often incomplete, non-standardised or unreliable, subjective assessments of financial performance relative to past performance and/or industry performance may need to be obtained from owner-managers.

Non-financial measures of performance which could be employed for a smaller enterprise include:

- Mere survival for another period, or the avoidance or amelioration of survival-threatening crises.
- Physical measures of input, output or activity in an absolute sense or relative to some scarce resource (for example, direct labour hours per unit or units of product per shift or customers served per day or sales per representative).
- Subjective assessments of the extent to which the concern has met the objectives of its owner-manager(s) regarding business matters such as customer satisfaction, technological advancement, resource self-sufficiency, employee turnover and lost-time accidents; and regarding personal matters such as disposable income and preferred life-style.

The point of this sub-section of the chapter has been to provide an early indication of ways in which the present research might aspire to measuring business growth and performance in smaller enterprises. In fact, the survey instrument for the AMC *Best Financial Practice* study relies heavily upon subjective assessments of business growth and performance from respondents. The measurement issues this raises are addressed at some length in Chapter 2 of the thesis.

#### **1.2.3.5 Financial Reporting Practices**

For the purposes of this study, financial reporting practices comprise financial reporting and analysis, and also some aspects of financial planning and control. The focus is upon the three most common standard financial reports or statements relating to an enterprise's affairs in an overall sense:

- Balance sheet (or statement of financial position).

- Profit and loss statement (or profit and loss account or income statement).
- Cash-flow statement (or statement of cash-flows or statement of sources and uses of cash).

Both historical and future-oriented forms of these financial statements are of interest to the research. Note that specific purpose financial reports or statements of the type usually advocated for cost and management accounting purposes in business segments, whether historical or future-oriented, are not considered.

Financial reporting practices are considered to extend to the analysis and interpretation of historical financial reports in particular. Analysis is seen as breaking down the comprehensive and complex set of facts and figures presented in financial reports into more focused and simplified pieces of insightful information about the business concerned. Interpretation is seen as explaining the meaning and implications of the information revealed by analysis. Together analysis and interpretation are intended to lead to a clearer and more revealing account of a business's financial position and performance. In this thesis, as in many other writings, the shorter descriptor 'financial analysis' is frequently used when referring to both analysis and interpretation activities. Specific techniques for the analysis and interpretation of historical financial reports may include comparisons of key figures with those in financial statements of previous periods, or with target figures in forecasted financial statements. The calculation of financial ratios, and their comparison with available benchmarks for such measures, might also be undertaken.

The primary concern in this research is with preparation and use of standard financial reports for internal financial management purposes involving owner-managers and, to a lesser extent, non-managing owners and managerial employees of smaller enterprises. This emphasis can be contrasted with a possible focus upon the provision of financial reports to outside parties such as taxation authorities and corporate regulatory bodies, or like financiers and development agencies needing to make reliable assessments of potential returns/benefits and perceived risks of providing financial and other forms of support to smaller business concerns. Having made this distinction in broad motivations for undertaking financial reporting, it will become evident that the two are interrelated – with the dictates of the latter purpose significantly influencing the nature of financial reporting undertaken for the former reason. Thus, the impact of imperatives shaping external financial reporting by SMEs upon their internal financial reporting practices is also of concern to the research.

While the *AMC Best Financial Practice* study was much broader in the scope of its inquiry into financial management, there are a substantial number of questions in the survey instrument which seek information on respondents' financial reporting practices, as defined above. More detailed consideration of the meaning and significance of financial reporting on a business's affairs is presented in Chapter 3 of the thesis. In particular, the accounting and legal contexts of financial reporting by small and medium-

sized enterprises in Australia are examined. It is indicated that the financial reporting practices of smaller business concerns, especially those which are legally organised as proprietary companies, are presently under close scrutiny by the accounting profession and corporate regulators, not to mention taxation authorities. The SME sector itself has identified increasingly more onerous financial reporting demands as just one of a number of allegedly unjustified regulatory burdens impeding its progress (Small Business Coalition, 1994). In considerable measure, the public debate on SME financial reporting is not well informed, there being very little reliable evidence to support competing views on whether the financial reporting burden should be made more onerous, or less so. These circumstances certainly accentuate the timeliness and relevance of this research.

### 1.2.3.6 Proprietary Company

The smaller enterprises of interest to this study are those legally organised as proprietary companies, as presently conceived by the Australian Corporations Law – thus excluding sole proprietorships and partnerships. As the legal specification of what constitutes a proprietary company in Australia is quite complex, its presentation is deferred until Chapter 3 of the thesis. At this point, it is sufficient to say that, in law, proprietary companies are corporate entities with limited owner numbers, restricted ability to transfer ownership, and no direct access to public markets for debt and equity. They typically have the privilege of limited liability. In the case of SMEs, proprietary companies are usually truly private in that none of their shares are owned by public companies.

Freedman & Godwin (1994, p. 234) indicate that a focus on proprietary companies is not uncommon amongst smaller enterprise researchers:

It would appear that, in so far as the issue is considered at all, the limited liability company is of more interest to the small business research community than are unincorporated firms; . . . limited liability companies and entrepreneurship have become equated, or at least associated.

Furthermore, proprietary companies are currently of considerable policy significance in this country. A good deal of the federal government's present effort to reform and simplify the Australian Corporations Law concerns proprietary companies, including mandated financial reporting by such concerns. Given that the *First Corporate Law Simplification Act 1995* became operative in December, 1995, and that the postal survey in the AMC's *Best Financial Practice* study was conducted in November, 1995, this thesis essentially presents the findings of a large-scale and representative pre-simplification benchmark study that the Corporations Law Simplification Task-Force might wish to have had to inform its deliberations prior to making new law on financial reporting by proprietary companies.

Further justification for restricting the businesses of interest in the present study to proprietary companies rests on the following grounds:

- As indicated in Chapter 3 of the thesis, the *First Corporate Law Simplification Act 1995* provides for the establishment of one member/director companies where previously a minimum of two had been required. A possible outcome of this, and other recent reforms, is a reduction in the proportion of Australian smaller enterprises organised as sole proprietorships or partnerships. Incorporation as a proprietary company is likely to become a more feasible option for smaller enterprises which might otherwise be organised either as a sole proprietorship, or as a partnership with the nominal participation of, say, a spouse. Thus, this study focuses on the proprietary company as an increasingly more predominant form of legal organisation for small and medium-sized enterprises in this country.

The latest compendium of statistics on small enterprises published by the Australian Bureau of Statistics (1996a) indicates that, as at June, 1995, 62.8 per cent of small manufacturers (with fewer than 100 employees) were organised as companies. It is also indicated that 95.5 per cent of medium-sized and large manufacturers (with 100 employees or more) were companies. The results of the Australian federal government's 1995 Business Longitudinal Survey indicate the following proportions of companies amongst employing manufacturing businesses of various sizes in the year of data collection for the present study (Industry Commission & Department of Industry, Science and Tourism, 1997):

**Table 1.3: Australian Manufacturing Companies, 1995**

Size Range (number of employees)	Proportion Legally Organised as Company (per cent)
1 to 4	47.6
5 to 19	70.3
20 to 99	84.1
Over 100	92.2
All Manufacturing	63.0

Clearly, the proportion of manufacturing businesses legally organised as companies increases with enterprise size. Although no specific statistics are provided above, it is not unreasonable to assume that most small and medium-sized manufacturers with corporate legal status are proprietary companies. This suggests that the population for this study is unlikely to be diminished unacceptably if interest is restricted to proprietary companies.

- The focus in this research is upon smaller enterprise growth, and it is more likely that this will be evident in businesses organised as proprietary companies (Hakim, 1989; Gray, 1992; Freedman & Godwin, 1994; Hughes & Storey, 1994; Yellow Pages Australia, 1995). While it is not possible to generalise unequivocally, it is frequently the case that sole proprietorships and partnerships are the legal structures of choice amongst so-called life-style and income substitution small enterprises with limited growth and performance aspirations. Later in this chapter it is indicated that the recently published Small Business Index study entitled *A Special Report on Small Business Growth Aspirations and the Role of Exports* (Yellow Pages Australia, 1995) finds that higher growth aspirations are evident amongst smaller enterprises organised as proprietary companies. Businesses in the Small Business Index study had 19 employees or fewer, and so are at the smaller end of the enterprise size range of interest in this research. Nevertheless, 62 per cent of businesses with significant growth plans and 59 per cent of those with moderate growth plans are reported to be organised as proprietary companies. Over the whole sample, 54 per cent of respondents are reported to be organised as proprietary companies.
- Unincorporated smaller enterprises are subject to a completely different financial reporting *régime* from those organised as proprietary companies. The former are influenced by the reporting requirements of taxation legislation, and should be influenced by accounting concepts and standards promulgated by the Australian professional accounting bodies, provided they are reporting entities – which most often is not the case. The latter have the additional imperative of the Australian Corporations Law which, as may be seen in Chapter 3 of the thesis, can – but might not – add significantly to the financial reporting demands on smaller enterprises covered by the legislation. Empirical evidence reviewed in Chapter 4 indicates that the financial reporting practices of unincorporated businesses tend to be the unavoidable minimum; whereas those in proprietary companies, while not highly sophisticated, tend to be more substantial. Thus, if the primary intention in this research is to discover possible influences of financial reporting practices on business growth and performance, then unincorporated smaller enterprises are simply not the place to look.

Identification of independent proprietary companies amongst respondents to the AMC *Best Financial Practice* study is enabled by the inclusion of appropriately worded questions in the survey instrument. Further justification for focusing upon proprietary companies in this research is provided in Chapter 3 of the thesis when considering the accounting and legal contexts of financial reporting by SMEs in Australia.

As the discussion to this point has attempted to demonstrate, the overall specifications for the unit of analysis in the present study given in this and the preceding sub-sections of the chapter are sympathetic to recent Australian federal government

thinking on smaller enterprises and financial reporting. Business concerns which meet the specifications are undeniably important in the current Australian economic and social policy environment. The choice of employment numbers as a size measure seems to have wide international support. The specifications are not without precedent in prior Australian and overseas research. And, most importantly, the specifications adequately delimit an identifiable and reasonably accessible population from which a study sample is drawn.

#### 1.2.4 Initial Justification of the Research Question

To the extent that greater sophistication in financial management is presumed to lead to improved financial control, such competence has frequently been represented by researchers, educators, policy-makers and business advisers as a necessary but not sufficient condition for the success of growth facilitating and/or performance enhancing strategies in smaller enterprises (Hutchinson *et al.*, 1975; Ray, 1980a, 1980b; Hutchinson *et al.*, 1981; Ray & Hutchinson, 1983; Gibb & Scott, 1985; Ray & Hutchinson, 1985; Gibb & Scott, 1986; Hutchinson & Ray, 1986; Gibb & Davies, 1989, 1990, 1991; Keasey & Watson, 1993; Peel & Wilson, 1996). A leading small enterprise researcher in the United Kingdom, Curran (1988, p. 26), who is a sociologist by background and presumably less than likely to have a financial bias, comments as follows on training priorities for owner-managers of SMEs:

There are sound arguments for making finance the key managerial function in small business training. From raising finance and especially in relation to day-to-day control, money matters are never far from the centre of decision-making and survival in the small enterprise. Yet, there is considerable evidence that many small business owners either fail or refuse to give finance and financial control sufficient priority. In part ignorance is the culprit: preparing a sound business plan, for example, requires basic knowledge and techniques which most people do not have. Day-to-day financial control often falls victim to the functional innumeracy and dislike of 'numbers' widespread in Britain.

The mention of a business plan and reference to numbers in this quotation are, of course, allusions to the role of financial reporting in sound financial control.

Some recent Australian evidence that tends to support Curran's (1988) assertions on neglect of financial management in smaller enterprises, at least for businesses at the lower end of the size range of interest in the present study, is provided by a survey of approximately 1.25 million operators of non-agricultural concerns with fewer than 20 employees conducted by the Australian Bureau of Statistics (1996f) in 1995. Only 12 per cent of respondents intended to send employees on training courses in the six months subsequent to the survey; and just 7 per cent of these indicate the training would be in the area of financial management. Only 18 per cent of respondents report having a written business plan. Financial management is not amongst perceived factors leading to business success identified by respondents that consider their small enterprise to be highly successful. On the other hand, 65 per cent of respondents had consulted an external accountant in the year leading up to the survey. This evidence of a low



emphasis or priority accorded to financial management is consistent with that of previous larger-scale surveys of training practices in Australian small enterprises such as those of Bailey & Royston (1980) and Meredith (1984).

Peel & Wilson (1996, p. 53) lend support to Curran's (1998) position on the importance of training in financial management for smaller enterprise owner-managers by drawing attention to recent research in one region of the United Kingdom which reveals that:

. . . no less than 81 per cent of small businesses which failed in the area, did so largely in consequence of the poor financial management skills of their owners. As a result, small businesses in the locality are being offered cheaper (discounted) bank finance, if their owners undertake to attend financial management training courses.

Later in his article, Curran (1988, p. 29) highlights the linkages between unplanned or imprudent business growth, poor financial control and poor enterprise performance as follows:

A common reason for failure among new – and sometimes even longer established small businesses is over-trading – often through expanding into bankruptcy through taking on more orders without recognising that expansion needs financing. Financial control is often crucial to survival in a way that other managerial functions are not because there is usually more tolerance of poor performance in these other functions. However, . . . poor financial control often spills over into poor performance of the marketing and production functions also. Trainers should give top priority to imparting basic financial skills even if those taking the course are resitant – especially those who have not actually run a business as yet – to too much emphasis on 'boring numbers'.

The significance of linkages between growth, financial control and performance is a recurring theme in much recent literature dealing with financial management of smaller enterprises (Hutchinson *et al.*, 1975; Ray, 1980; Hutchinson *et al.*, 1981; Ray & Hutchinson, 1983; Peacock, 1985a; Ray & Hutchinson, 1985; Hutchinson & Ray, 1986; McMahon, 1989, 1990a, 1990b, 1990c; Moores, 1990; Romano, 1990; McMahon & Davies, 1991a, 1991b; McMahon, 1992; McMahon & Davies, 1992a, 1992b; McMahon *et al.*, 1992a, 1992b; Romano & Ratnatunga, 1992; Moores & Mula, 1993; McMahon & Davies, 1994; McMahon *et al.*, 1994a; Romano & Ratnatunga, 1994, 1995). Without exception, these highlight the stresses, even crises, produced in the smaller enterprise by growth, and the need for changes in the way the business is organised and managed if it is to cope with the stresses and survive to prosper. Many of the publications cited in this paragraph also strongly emphasise the importance of timely and relevant financial reporting to sound financial control.

The available empirical evidence suggests that problems arising from owner-managers of smaller enterprises being disinclined to undertake what is considered to be sound financial planning and control, and choosing not to obtain and use reliable financial reports, are common in Australia and elsewhere (Hutchinson, 1964; Luoma, 1966, 1967; Bolton, 1971; Abdelsamad *et al.*, 1977; Meredith, 1977; Potts, 1977; Clute, 1979; Larson & Clute, 1979; Hankinson, 1982; Khan & Rocha, 1982; Berryman, 1983;

Hankinson, 1983; Peterson *et al.*, 1983; Arnold-McCulloch & Lewis, 1985; DeThomas & Fredenberger, 1985; Peacock, 1985a, 1985b, 1985c; Arnold-McCulloch & Lewis, 1986; Holmes, 1986; Ibrahim & Goodwin, 1986; Williams, 1986; Holmes, 1987a, 1987b; Peacock, 1987; Holmes, 1988; Holmes & Nicholls, 1988; Greer, 1989; Holmes & Nicholls, 1989; Holmes *et al.*, 1989; McMahon & Holmes, 1989, 1990; Hall & Young, 1991; Holmes & Nicholls, 1990; Holmes *et al.*, 1990, 1991a, 1991b; McMahon & Holmes, 1991, 1992; Berryman, 1993; McMahon *et al.*, 1993a; Australian Bureau of Statistics, 1996a).

Such research indicates that, in addition to inevitable claims of insufficient time from owner-managers, possible reasons for not undertaking formal financial reporting in smaller concerns include:

- Preferred management styles that rely upon direct observation and hands-on control of business operations. There seems to be a conviction that management which relies upon formal financial reporting is less effective than more direct approaches. There may also be a preoccupation with day-to-day survival and a disinclination to plan ahead, meaning future-oriented financial reports are rarely used.
- Non-trivial costs of set-up and implementation of formal financial reporting systems. Being inherently fixed in nature, these costs generally fall more heavily, in relative terms, upon smaller businesses than on their larger counterparts (Horowitz & Kolodny, 1982; Nair & Rittenberg, 1982; Abdel-Khalik, 1983; Nair & Rittenberg, 1983; Friedlob & Plewa, 1984; Knutson & Wichmann, 1984; Carsberg *et al.*, 1985; Hildebeitel, 1986; Friedlob & Plewa, 1992).
- Unfamiliarity with common financial statements and techniques for their analysis. This may be due to a lack of training or experience, or both. Awareness of this skill requirement is frequently low, and the motivation to acquire it is often limited until financial problems arise.
- Knowledge that common financial statements do not provide the types of information (for example, market opportunities and competitive circumstances) considered essential to survival and success. There is also cynicism regarding the decision usefulness of information contained in financial reports prepared on an historical cost basis.
- Belief that formal financial reporting represents a threat to privacy and competitive advantage if the information presented should become available to outside parties. There may also be deliberate efforts to conceal financial information from parties that have genuine, possibly legally enforceable, rights of access to such information including non-managing owners, financiers, taxation authorities and corporate regulatory bodies.

It is important to acknowledge that non-use of formal financial reports in management of small and medium-sized enterprises is not necessarily a consequence

of irrationality, neglect or incompetence on the part of owner-managers (Young, 1987; Gibson 1992a, 1992b, 1992c, 1993). It is entirely possible that considered judgments have been made leading to this outcome. Furthermore, permission and even encouragement not to prepare formal financial reports may be considered to have been granted by recent moves to exempt smaller business concerns from financial reporting requirements imposed on their larger counterparts by the accounting profession and corporate regulatory bodies (Australian Accounting Research Foundation, 1990a, 1990b; McMahon *et al.*, 1992c, 1993b, 1994b; Australian Accounting Research Foundation, 1995a; Factor, 1995a; Govey, 1995; King, 1995; KPMG, 1995; Parker & Reilly, 1995; Anon., 1996; Ford & Ramsay, 1996; Govey, 1996; Wagner, 1996).

Notwithstanding the points made in the previous paragraph, there appears to be a widely-held view amongst researchers in the field that non-existent or poor financial reporting practices are at the root of financial problems frequently encountered by small and medium-sized business concerns. For example, following his research, Potts (1977, p. 91) highlights most succinctly the significance of financial reporting in sound financial management of North American small enterprises as follows:

... the clearest and most startling distinction between successful and discontinued small businesses lies in their approach to the uses which can be made of accounting information ...

Williams (1986, p. 212) comments on reasons for failure in his 12-year longitudinal study of over 10,000 Australian small enterprises as follows:

... owner/managers of almost one third of the failed firms in this study attributed a general inability to properly manage the financial resources of their firms as the major 'cause' of business failure.

In exit interviews with owner-managers of over 5,000 businesses that failed from 1973 to 1984, inadequate or inaccurate or non-existent accounting records was given as a reason for failure by 55.4 per cent of interviewees. Inability to use and understand financial statements was cited as a reason for failure by 17.8 per cent of interviewees. Almost 60 per cent of businesses in the study reported preparing financial statements no more frequently than annually. The following financial reporting characteristics were found to have a statistically significant positive relationship ( $\alpha=0.05$  or better) with survival and good performance amongst the small enterprises investigated:

- Adequacy of accounting records.
- Frequency of financial reports or statements.
- Use of financial reports by owner-managers in decision-making.

Findings such as those of Potts (1977) and Williams (1986) on linkages between deficient financial reporting practices and business failure are common in other published research studies over many years and from numerous countries. Comprehensive reviews of the international literature dealing with small enterprise failure have been conducted by Berryman (1983), Peacock (1985a) and Berryman (1993). After surveying the literature, Peacock (1985a, p. 48) affirms:

The positive correlation between poor or nil financial management (including basic accounting) and business failure has been well documented in western countries.

This conclusion is strongly upheld by Berryman (1983, 1993).

Against this background, an assertion that this thesis appropriately highlights the particular contribution that better financial reporting might make to the success of smaller manufacturing enterprises seeking to grow seems more than plausible. Careful scrutiny of the relevant literature strongly suggests that the principal research question stated at the outset of the chapter has not been explicitly addressed in previous scholarly investigations. The remainder of the thesis is directed towards justifying the claim that the present research advances knowledge in the area beyond what previously could be construed as credible and well-intentioned supposition.

### **1.3 Smaller Enterprise – International and Australian Perspectives**

It is now useful to briefly consider, in general terms, why in recent times small and medium enterprises have become a major force in business internationally. The last three decades or so have seen SMEs re-emerging as significant units of production or service in developed and developing economies worldwide. This has been attributed to factors such as their increasingly more important role in job creation and the benefits of flexible specialisation which favour smaller scale business operations (Piore & Sabel, 1984; Sengenberger *et al.*, 1990; Lovernan & Sengenberger, 1991).

Focusing specifically on why there is increased internationalisation of smaller enterprises, Hall (1992, p. 2) observes:

International trade and investment flows have usually been associated with large firms. In the past decade SMEs have played a more important role in the globalisation of economies. There are three basic reasons for this: First, the relative value added opportunities arising from international activities seem to be changing in favour of smaller economic units. Second, a number of environmental and technological factors (such as better and cheaper technology for producing and managing) are changing the relative competitive advantage of SMEs. Third, new strategic forms (partial integration, networks, alliances) are emerging which allow SMEs to play a greater role in international markets.

Explaining his first point, Hall (1992) points out that value chains in business operations are coming to be dominated by service and distribution activities, causing the core manufacturing component to diminish as a proportion of total added-value. Importantly, small and medium enterprises often enjoy a competitive advantage in service and distribution. Furthermore, given the emergence of powerful economic alliances, such as the OECD, the APEC forum and the Association of Southeast Asian Nations (ASEAN), with alignment of regulatory and taxation *régimes* between member countries, competitive advantage arising from location is becoming less important, again favouring smaller businesses. Australia is a member country of the OECD and APEC, and it has observer status in ASEAN. All three alliances have now formally recognised the considerable importance of small and medium enterprises to the economic well-being of

member countries individually and collectively. Consequently, they have instituted policies and programmes intended to foster and develop the smaller enterprise sector.

Hall's (1992) second point rests mainly on the well-documented competitive advantage small and medium enterprises frequently enjoy in technological and managerial innovation. A McKinsey & Company (1993a) report to the Commonwealth Scientific and Industrial Research Organisation entitled *Towards Successful Support for Australia's Small and Medium-Sized Enterprises* and a Bureau of Industry Economics (1994) report entitled *Small Business Innovation* provide recent evidence of this in the Australian context. Hall's (1992) final point recognises the emergence of new forms of business organisation like networks, strategic alliances and trading companies which serve to diminish any size-related disadvantages SMEs might experience. Recent persuasive evidence on the increasing importance of organisational linkages such as networks and strategic alliances amongst Australian smaller enterprises is provided in the McKinsey & Company (1994) report to the Australian Manufacturing Council entitled *The Wealth of Ideas: How Linkages Help Sustain Innovation and Growth*. Further evidence on this development is contained in the Bureau of Industry Economics (1995a) report entitled *Beyond the Firm: An Assessment of Business Linkages and Networks in Australia*.

Another recent report to the Australian Manufacturing Council (McKinsey & Company, 1993b p. 4) attributes the global re-emergence of small and medium enterprises to 'the dynamic interrelationship among changing consumer preferences, changing competitive conditions and changing technology'. This view is justified in the report as follows:

- Consumers are demanding more specialised and customised products, leading to niche markets which SMEs are better suited to serve than larger businesses.
- Increased competition in a progressively more dynamic world economy favours smaller enterprises with latter, more flexible and more responsive organisation structures in which information flows become less distorted. The more bureaucratic organisation structures of larger businesses are less able keep pace with the rapid economic change which has now become the norm.
- Technological innovations, especially in electronic microcircuitry, enable small and medium-sized producers or service providers to compete with larger concerns on cost and quality with greater flexibility. Newer information technologies, such as microcomputers and facsimile communication, bring management systems previously accessible only to larger businesses well within the reach of SMEs.

On the last point, the report observes (McKinsey & Company, 1993b, p. 6):

New technology has helped SMEs to compete more effectively and move into export markets. *International Business Week* . . . reports ' . . . the fax machine in particular has given grassroots exporters a chance, allowing them to make sales pitches, book orders and even advertise across the globe at low cost'.

The contribution of the facsimile machine was frequently referred to in interviews with emerging exporters.

A most interesting light on the attractions of smaller enterprise size in conducting business in the present and future economic environment is shed by the Industry Task Force on Leadership and Management Skills report (Karpin, 1995, p. 75) in observing:

Small to medium enterprises, especially those in high value added industries, have been identified globally as the vanguards of future innovation, growth and employment. These enterprises have proved to be flexible, creative and quick to seize opportunities. These virtues have also been recognised by larger corporations, many of whom have restructured to create smaller business units within their organisations and many of whom have outsourced business tasks to smaller enterprises.

Thus, larger businesses seem to be effectively joining the ranks of small and medium-sized enterprises by reconstructing or downsizing their operations, or by allying themselves with such concerns through commercial ties.

#### 1.4 Significance of Smaller Manufacturing Enterprises

The significance of the Australian manufacturing sector over the last decade or so is indicated in data presented in the table below, reported by the Australian Bureau of Statistics (1996c, 1996g, 1997):

**Table 1.4: Significance of Manufacturing, 1982-83 to 1994-95**

Year	Manufacturing Share of Gross Domestic Product at Average 1989-90 Prices (per cent)	Manufacturing Share of Total Employment (per cent)
1982-83	17.0	n.a.
1984-85	16.3	16.2
1987-88	16.1	14.8
1989-90	15.2	13.5
1991-92	14.8	11.9
1992-93	14.9	11.9
1993-94	14.7	12.1
1994-95	14.7	12.0

These figures indicate a decline in the relative importance of manufacturing in the Australian economy which seems to have been arrested in the early 1990s. Of course, this has taken place at a time of rapidly increasing significance for the services sector as part of a global economic trend.

Data on the significance of small enterprises (as defined earlier) in the Australian economy are separately reported by the Australian Bureau of Statistics (1988, 1991, 1993a, 1996a). In 1994-95, there were around 786,000 small enterprises in the non-agricultural private sector – which was approximately 97 per cent of all businesses in that sector. These small enterprises employed a little more than 49 per cent of the workforce in the sector. Just over 220,000 small enterprises constituted somewhat in excess of 98 per cent of goods producing businesses and accounted for approximately 55 per cent of persons employed in businesses of this type. The Australian Bureau of Statistics (1996a) reports that in 1994-95 small enterprises represented 97.8 per cent of all businesses and 46.9 per cent of total employment in the manufacturing sector. Small manufacturing concerns amounted to 8.4 per cent of all business enterprises and provided 8.2 per cent of all employment in businesses in the Australian economy. Finally, small manufacturing concerns amounted to 8.6 per cent of all small enterprises and provided 16.6 per cent of employment in small enterprises.

As indicated earlier, data regarding the significance of medium-sized business enterprises in the Australian economy have not been specifically or separately reported by the Australian Bureau of Statistics in compendiums of statistics on the small enterprise sector. The most recently released official statistics on Australian manufacturing SMEs that include numbers of establishments are those provided by the Australian Bureau of Statistics (1996g) in a report on its annual manufacturing survey for 1993-94. Fortunately, the data are presented in enterprise size groupings in employment terms as in Table 1.5 on the next page.

At the close of 1993-94 there were 42,958 small and 1,483 medium-sized manufacturing establishments, making a total of 44,441 small and medium-sized manufacturing establishments in Australia at the time. The total number of manufacturing establishments was 44,610. The Australian Bureau of Statistics considers an establishment to be the smallest organisational unit for which separate accounts are kept, at least on an annual basis (Bureau of Industry Economics, 1995b). The data gathered could therefore include some sub-units of larger businesses along with truly independent smaller enterprises. Notwithstanding this, Table 1.5 clearly indicates the considerable importance of SMEs in Australia's manufacturing sector on each of the economic benchmarks reported. The Australian Bureau of Statistics (1996c) points out that the average size in employment terms of an Australian manufacturing establishment in 1989-90 was 25 persons. Corresponding figures for 1990-91, 1991-92 and 1992-93 were 24, 22 and 23 persons respectively. Using data from Australia's annual manufacturing survey for 1993-94, this figure is calculated to have subsequently fallen to approximately 20 persons (Australian Bureau of Statistics, 1996g).

Recent broad statistics on the significance of small and medium enterprises in member countries of the Organisation for Economic Cooperation and Development (OECD) and the APEC forum are provided by the forum for Asia-Pacific Economic

Table 1.5: Significance of Manufacturing Enterprises of Various Sizes, 1993-94

Enterprise Size Grouping	Establishments (per cent)	Employment (per cent)	Sales Turnover (per cent)	Wages & Salaries (per cent)
From 0 to 3 employees	34.1	3.6	2.0	2.0
From 4 to 9 employees	31.5	9.5	4.6	6.4
From 10 to 19 employees	15.0	9.7	5.9	7.6
From 20 to 49 employees	9.8	14.6	11.7	12.8
From 50 to 99 employees	3.9	13.0	12.6	13.0
From 100 to 199 employees	2.1	14.5	15.9	15.4
From 200 to 499 employees	1.2	17.6	22.2	20.1
From 500 to 999 employees	0.3	9.7	13.8	12.0
At least 1,000 employees	0.1	7.8	11.3	10.7
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Total Small Manufacturing Enterprises (fewer than 100 employees)</b>	<b>93.3</b>	<b>50.4</b>	<b>36.8</b>	<b>41.8</b>
<b>Total Medium-Sized Manufacturing Enterprises (from 100 to 499 employees)</b>	<b>6.3</b>	<b>32.1</b>	<b>38.1</b>	<b>35.5</b>
<b>Total Small and Medium-Sized Manufacturing Enterprises (fewer than 500 employees)</b>	<b>99.6</b>	<b>82.5</b>	<b>74.9</b>	<b>77.3</b>



Cooperation (1994) and Hall (1994, 1995a, 1995b). These sources indicate similar, if not greater, importance for manufacturing SMEs amongst Australia's major trading partners. Manufacturing SMEs are claimed to account for between 4 and 6 per cent of Gross Domestic Product (GDP) in the OECD member countries, and around 12 per cent of GDP in Asian economies. These OECD statistics need to be interpreted with some caution since, as indicated earlier, definitions of small and medium enterprises vary widely between OECD member countries.

## 1.5 Australian Context for the Study

### 1.5.1 Australian Manufacturing Sector Problems

The main purpose in this section of the chapter is to identify and describe the broader economic context into which the present research fits; and, in so doing, to further build the case that the present research is both potentially important in that context and also most timely.

Australia's economy has always been dependent for its vigour and resilience upon the export of goods to the rest of the world. Historically, the exported goods of greatest significance have been primary products (wool, meat, minerals, etc.) which have been shipped with minimal added value in terms of processing towards end products. For the first 20 years or so after World War II, the prosperity enjoyed by Australia was largely attributable to economic activity of this type, added as it was to strong domestic market growth with expansion of the population through immigration and improving standards of living. In these circumstances, manufacturing exports were not vital to economic well-being and the manufacturing sector focused upon the domestic market, making the most of high levels of tariff protection which shielded it from import competition, and enjoying the shelter of a fixed exchange rate *régime*. It was frequently not possible for manufacturers to realise full economies of scale because of the relatively small size of domestic markets; but, being cost efficient by world standards was not a concern as Australian manufacturers were generally not competing in international markets.

However, the subsequent slowing of growth in the domestic economy, the increasingly rapid pace of technological and economic change, and the general volatility of the international economy have shown Australia's dependence, as a comparatively small country, upon the export of primary products to be an extremely vulnerable economic strategy (Welch, 1982; Barrett & Wilkinson, 1985). The circumstances of Australian manufacturing in the mid-1970s after decades of being inward looking is captured succinctly by Jackson (1975, p. 1) as follows:

Australian manufacturing was largely created to serve a growing domestic market by deliberate policies of import substitution, immigration, fixed exchange rates and capital inflow . . . Now that the domestic market is satiated and can grow only slowly, most manufacturing is stalled and lacks purpose. It needs to export to grow.

Throughout the 1980s and early 1990s the export performance of Australian industry, in particular the manufacturing sector, has been a major preoccupation of policy-makers and government departments concerned with industry and trade. The floating of the Australian dollar late in 1983, a threatening fall in export earnings from Australia's traditional primary industry sources, recognition of widespread inefficiencies in work and managerial practices, a desire to increase the world competitiveness of Australian manufacturing, moves to reduce or remove high levels of tariff protection, the emergence of new and powerful trading blocs, deregulation of financial markets, growing import competition, historically high external current account deficits, rapidly escalating foreign debt, prolonged recession and high levels of unemployment have all served to focus political and economic attention on the need to stimulate Australia's export performance, and to diversify its basis across markets, sectors, industries, products and services.

There has consequently been a long series of government-sponsored and private inquiries into impediments to exporting from Australia, and also into direct and indirect means of fostering essential improvements in Australia's export performance. The extent and complexity of the issues grappled with are most evident in a special issue of the *Australian Journal of Management* (volume 16; June, 1991) edited by I. Marsh which is devoted to reporting the proceedings of a high-level conference on the theme *Internationalising Australia's Economy: Vision and Means in the Garnaut and Australian Manufacturing Council Reports*.

Regrettably, Australia's ability to respond to the challenge by broadening its export base has been severely hampered by its secondary and tertiary industries being underdeveloped and non-competitive by international standards. The unfortunate position of Australia in the early 1990s is reflected in the following observations (Arthur D. Little International, 1992, p. 10):

... the World Economic Forum and the International Institute for Management Development in their 1992 World Competitiveness Report have ranked Australia very poorly among the OECD nations in competitiveness, and have indicated that in many of the key competitiveness factors Australia's performance has slipped.

In a comparison of 22 OECD countries, Greece is the only one whose performance in internationalising its economy is judged to have been worse than Australia's.

The Industry Task Force on Leadership and Management Skills report (Karpin, 1995) to the Australian federal government indicates that in 1994 the World Economic Forum ranked Australia 13th out of the 22 OECD member nations, and 24th out of a total of 41 nations, in terms of internationalisation. Overall, Australia ranked 15th out of 41 countries in world competitiveness based on eight key measures of performance (domestic economic strength, internationalisation, government, finance, infrastructure, management, science and technology, and human resources).

## 1.5.2 Australian Manufacturing Council Reports

### 1.5.2.1 International Perspective on Australian Manufacturing

Since 1990, significant advances have occurred in general understanding of the factors which contribute to and impede the international competitiveness of Australian manufacturing industry. These advances have, in particular, been the result of a series of research studies conducted for the Australian Manufacturing Council (AMC), an advisory/consultative body to the Australian federal government Minister responsible for industry which comprised senior members of industry, trade unions and government appointed by the Minister. Notwithstanding its achievements in this regard, the AMC was wound up by the federal government in June, 1996.

Initially, the AMC commissioned a study into the structure, functioning and performance of the Australian manufacturing sector in the context of the global economy which resulted in a landmark report entitled *The Global Challenge: Australian Manufacturing in the 1990s* (Peppas *et al.*, 1990). Amongst the wide range of matters considered in this report was what was viewed to be a significant paradox (Yetton *et al.*, 1992, p. i):

It is generally accepted that Australian manufacturing firms don't export enough. Further, it is assumed that this is because they are not competitive. It is as if, in people's minds, exporting is synonymous with international competitiveness. In fact though, Australia does have world competitive manufacturing firms . . . They just don't export much from Australia. This paradox was recognised, but not resolved, in *The Global Challenge*.

A subsequent report commissioned by the AMC entitled *Going International: Export Myths and Strategic Realities* (Yetton *et al.*, 1992) considered the paradox identified in the previous paragraph in some depth. The terms of reference which Yetton *et al.* (1992) address are as follows:

- Is the extent of internationalisation and the process and pattern within Australian manufacturing industries different from other countries, and if so, in what ways?
- What are the factors driving the differences in Australia, and what are the likely scenarios for the ownership, structure and performance of Australian industry?
- What are the implications of these scenarios for the Australian economy, particularly the external account?
- What, if any, policy changes are required to maximise the benefits of the process of internationalisation for Australia?

A significant finding of the Yetton *et al.* (1992, p. i) study is that 'Australian international manufacturing firms are . . . capitalising on their competitive advantage by pursuing multi-domestic strategies of producing in countries in which they sell, rather than acting as strategic exporters'. In this light, it is considered that larger manufacturing enterprises cannot really be relied upon to deal with Australia's present current account deficit and unemployment problems. Thus, there is a need for policy-makers to look elsewhere for

opportunities to build strengths in international trade in goods and services from Australia. One significant opportunity identified by Yetton *et al.* (1992, p. ii) is 'emergent Australian firms which are developing such strengths, are currently too small to be strategic exporters, and whose development should be promoted'.

### 1.5.2.2 *Emerging Exporters Study*

Determined to identify in which areas of the Australian economy possible future strategic exporters might already exist, the AMC commissioned a third major report entitled *Emerging Exporters: Australia's High Value-Added Manufacturing Exporters* (McKinsey & Company, 1993b). This report served to focus the attention of policy-makers, in an enthusiastic and most optimistic manner, on the current and potential future contribution of small and medium manufacturing enterprises to Australian economic well-being through internationalisation of their activities. The report attributed significant growth in Australia's elaborately transformed and other high value-added exports over the preceding five years mainly to 700 small and medium-sized, high value-added manufacturers each exporting between \$2 million and \$50 million worth of goods annually (about \$8.1 billion in total each year). These emerging exporters, distributed across a wide range of industry sectors, had doubled their exports in real terms since 1986-87, and they were expected to do so again in the ensuing five years. McKinsey & Company (1993b) considered small and medium-sized enterprises to be those with under \$100 million annually in total sales or fewer than 500 employees. A number of subsidiaries of larger corporations were included amongst the 700 emerging exporters on the basis that they were judged to be independently operated.

The research method employed in the *Emerging Exporters* study first involved a mailed questionnaire survey of a sample of high value-added manufacturing firms identified through key informants. This produced 310 responses for a response rate of 44 per cent. Next, interviews were conducted with high-growth exporters (21 enterprises), moderate-growth exporters (14 enterprises), non-exporters (15 enterprises) and six financial institutions. Subsequently, focus groups were conducted for the chief executives of 30 of the fastest growing exporters. Finally, workshops were held with policy-makers from key government departments at both federal and State/Territory levels.

From the viewpoint of the research described in this thesis, the key findings of the *Emerging Exporters* study include:

- Two kinds of exporting enterprises are identified: those described as 'born global' and those termed 'domestic based'. The born global enterprises are characterised as being international in their perspective from the outset; on average, undertaking their first export orders around two years from start-up, exporting 76 per cent of their total sales, having around \$12 million in export sales annually, and having an annual growth rate of 15 per cent. The domestic-based enterprises

are characterised as traditionally serving domestic markets, but now focusing upon export markets; on average undertaking their first export orders around 27 years from start-up, exporting 20 per cent of their total sales, having around \$12 million in export sales annually, and having an annual growth rate of 10 per cent.

- Both kinds of exporting enterprises are found to be faced with issues concerning management transition as they grow through exporting. For example, the study report (McKinsey & Company, 1993b, p. 13) indicates:

Issues concerning management transition arise once the born global firm reaches about \$10 million to \$20 million in export sales. This occurs more quickly than in domestic-based firms because of the greater complexities of managing a relatively new and fast-growing firm, with complex products selling in many markets. Management skills are a constant constraint. As one exporter put it 'Undercapitalised, understaffed and learning the hard way. That's our story'.

Notice the allusion here to a financial problem commonly associated with business growth (that is, undercapitalisation). For domestic-based enterprises, the study report indicates that 'Management skills are an issue, but more so in relation to export skills than general management skills' (McKinsey & Company, 1993b, p. 15).

- An average of 90 per cent of business enterprises across all sectors of manufacturing were found to be non-exporters; although the report claims that these 6,200 or so small and medium enterprises could be exporters with an appropriate attitude change amongst their managers, together with reductions in informational and other constraints on exporting. Fifteen policy recommendations to this end are made in the report.
- Amongst the constraints on small and medium-sized manufacturers identified in the study report are a lack of management skills which impacts in at least two ways. First, many manufacturing SMEs are claimed to be deficient in financial reporting in that they (McKinsey & Company, 1993b, p. 50):

... lack the financial and business strategy skills to present their business in a way that appeals to potential financiers. Many financiers complain that firms miss out on finance because they are unable to provide meaningful cash flow summaries for the business. Management education for smaller firms is important.

A second, broader impact is identified in the following terms (McKinsey & Company, 1993b, p. 52):

As well as ongoing skill needs, all businesses face moments of great change in their life cycle when a major skills shift or management transition is required. The first major change occurs when a business moves from being a small, privately run outfit and becomes a medium-sized, professionally managed unit, incorporating all the systems and operational capabilities of modern enterprises. Although this point of management transition occurs at different times for different firms, virtually all firms of \$20 million to \$30 million in sales have dealt successfully with a major transition issue. The change occurs earlier for export firms (between \$10 to \$20 million in total sales) because of the added complexity of export

markets. However transition issues occur late in the firm's life relating to fundamental strategic direction.

The policy recommendation which is made in the *Emerging Exporters* study report relating to the management transition problems detailed in the last point above reads (McKinsey & Company, 1993b, p. 53):

Management transitions are a complicating factor to continued high export growth for smaller firms.

The profile of management transition issues needs to be raised in Australia through channels such as business school research and journalistic reporting.

The Government may need to provide some leadership to launch this important issue by funding specific business school projects that can build a better understanding of the issue in Australia and raise its profile.

The study described in this thesis is just the type of research called for in the recommendation above, albeit for *financial* management transition in smaller manufacturing enterprises that might be growing through domestic and/or export activity.

### 1.5.2.3 Innovation and Best Practice Studies

The three reports of the Australian Manufacturing Council so far highlighted (Pappas *et al.*, 1990, Yetton *et al.*, 1992 and McKinsey & Company, 1993b) provided very strong impetus for further studies conducted by, or on behalf of, the AMC into exporting, networking, innovation, and manufacturing and financial best practice amongst Australia's manufacturing SMEs. The common objective of these studies was to appropriately inform the provision to the federal government by the AMC of policy and programme advice on these matters.

The *Emerging Exporter* study report (McKinsey & Company, 1993b) led directly to a further McKinsey & Company (1994) report to the Australian Manufacturing Council entitled *The Wealth of Ideas: How Linkages Help Sustain Innovation and Growth*. The relationships or linkages considered in the study include those with customers, suppliers, research and development providers, and other businesses in the same industry. In turn, the *Wealth of Ideas* study spawned a further investigation that set out to ascertain the characteristics of Australian manufacturing SMEs that successfully use product innovation as their competitive strategy. The report on this study is entitled *The Innovation Cycle: Practical Tips From Innovative Firms* (Australian Manufacturing Council, 1995).

The early report to Australian Manufacturing Council entitled *The Global Challenge: Australian Manufacturing in the 1990s* (Pappas *et al.*, 1990) led to on-going research into the movement of Australian manufacturing SMEs towards a 'new workplace culture' focused on international best practice. This line of inquiry, motivated by the quest for international competitiveness, culminated in a further report from the AMC entitled *Leading the Way: A Study of Best Manufacturing Practices in Australia and*

*New Zealand* (Australian Manufacturing Council 1994). Findings of the *Leading the Way* study encouraged the AMC to undertake a final study more specifically concerned with best financial practice. The AMC publication entitled *Practising Balance: Integrating Best Financial Practice Into Your Business* (Australian Manufacturing Council, 1996, p. 5) reports the following key objectives:

- Identify, empirically, the financial practices of Australian manufacturing SMEs and the lending requirements of financial institutions.
- Define and describe the implementation of best financial practice.
- Encourage firms to adopt best financial practice as part of their overall management strategy.
- Raise firms' awareness of the requirements and expectations of lenders.

As these objectives imply, the *Best Financial Practice* study actually involved two surveys – one for Australian manufacturing SMEs and another for financial institutions in this country that can provide debt finance to such concerns. The primary focus in this thesis is the findings of the SME survey; although, late in Chapter 3 of the thesis, the financial institutions survey receives some attention for light it may shed on expectations of lenders regarding the provision of financial information by smaller enterprises.

The significance of the *Best Financial Practice* study for the present research is underscored by the definition of best financial practice adopted by the AMC (Australian Manufacturing Council, 1996, p. 6) (*italics added for emphasis*):

Best financial practice . . . is the integration of the finance function into a firm's overall operation to improve business performance and facilitate funding for growth. It contributes to the competitiveness and profitability of an organisation through providing financial management leadership, *timely management information and the highest quality financial reporting* and control.

Clearly then, financial reporting as defined in this thesis is a key element of best financial practice so conceived by the AMC. It is for this reason that there are a substantial number of questions in the *Best Financial Practice* survey instrument for SMEs which seek information on their financial reporting practices (see the instrument presented in Appendix B to the thesis). As the essential purpose of the thesis is to describe and analyse the *Best Financial Practice* survey data, no discussion of the findings of this AMC study is undertaken at this point.

### **1.5.3 Small Business Index Special Report**

Yellow Pages Australia (1995) recently published *A Special Report on Small Business Growth Aspirations and the Role of Exports* as part of its Small Business Index series.

This study sought to discover (*inter alia*):

- The extent to which small enterprises in the sample wish to grow.
- The extent to which exporting is a part of their growth plans.
- The extent to which certain financial management tools are used.

The focus on growth is clearly an important common denominator between the Small Business Index special report and the present research, as is consideration of some financial management practices amongst growing small enterprises.

The research method employed in the Small Business Index investigation was telephone interviews with a panel of at least 1,000 randomly selected owner-managers of small enterprises with 19 employees or fewer. This was a quota sample intended to replicate the defined small enterprise population in Australia as to geographic location and industry. The panel is obviously concentrated amongst businesses at the smaller end of the enterprise size spectrum of concern in the present study.

From the viewpoint of the research described in this thesis, the key findings of the Small Business Index special report include:

- The average size of businesses in the sample is 4.58 employees and 8 per cent of the sample are manufacturing concerns. The growth aspirations of the sample enterprises are: 3 per cent to become smaller, 28 per cent to stay the same size, 61 per cent to achieve moderate growth and 8 per cent to realise significant growth. In manufacturing, 60 per cent aspire to moderate growth and 7 per cent to significant growth. Higher growth aspirations are evident amongst businesses engaged in services, amongst those with a greater number of employees and higher sales turnover, amongst those organised as proprietary companies, and amongst those most recently established. The achieved average rate of growth in employment numbers in the last year is minus 6 per cent for no growth aspirants, 4 per cent for moderate growth aspirants and 10 per cent for significant growth aspirants, with the average for all enterprises in the sample being 2 per cent.
- The extent of use of certain financial management tools amongst respondents in the Small Business Index study is reportedly as shown in the table below:

**Table 1.6: Financial Management Tool Use in Small Business Index Study**

<b>Financial Management Tool Used</b>	<b>Significant Growth Enterprises (per cent)</b>	<b>Moderate Growth Enterprises (per cent)</b>	<b>No Growth Enterprises (per cent)</b>	<b>All Enterprises (per cent)</b>
<b>Formal budgets</b>	61	46	40	45
<b>Cash-flow projections</b>	74	64	41	58
<b>Written business plans</b>	78	41	28	40
<b>Computerisation</b>	91	79	58	74



There is support in these findings for the premise that small enterprises which aspire to more substantial growth are more likely to use the financial management tools indicated.

#### 1.5.4 Financial Management and Support for SMEs

Further justification for the present research is now sought amongst the findings of some recent studies of smaller enterprise skill requirements commissioned or supported by the Australian federal government. The position is taken that if such inquiries have identified financial management skills or competencies as being important to and lacking in owner-managers and their employees, then the potential significance of the present research is enhanced. Recent examples of support available to Australian SMEs in the area of financial management are then briefly described. Provision and use of such support constitute *prima facie* evidence of the importance of increased sophistication in financial management, including financial reporting, when small and medium-sized enterprises seek to grow and/or internationalise their business activities.

In the federal House of Representatives Standing Committee on Industry, Science and Technology report entitled *Small Business in Australia: Challenges, Problems and Opportunities* (Beddall, 1990, p. 209) it is indicated that (*italics added for emphasis*):

Small businesses require specific management skills which need to be acquired to lay the foundation for a viable business. These fall into two areas: first, operational skills such as *financial planning, cash flow management, debt collection*, work scheduling and priority setting; and second, strategic skills when the owner/manager can no longer control all aspects of the business and needs to develop long term planning objectives, and delegation and communication skills.

Notably, the italicised skills in this statement fall into the domain of financial management. In a longitudinal study conducted for the Australian federal government, Williams (1992) indicates that just over 48 per cent of owner-managers in his sample believe there are significant skill deficiencies amongst their employees in the area of financial management.

A recent report to the Australian federal government by the Employment and Skills Formation Council of the National Board of Employment, Education and Training which focuses on small enterprise employment and skills (Carmichael, 1994, p. 8) points out that (*italics added for emphasis*):

Traditionally, Australian small business owner/managers have had low to very low educational attainment levels, with many failing to complete their schooling. Related to this, small business owner/managers are commonly held to have poor management skills (including in particular *financial management skills*).

The report goes on to indicate that reportedly high failure rates and difficulties in gaining access to finance amongst smaller enterprises have been attributed to these skill deficiencies.

In 1994, the National Investment Council, an advisory body to the then federal Minister for Industry, Science and Technology on investment related matters, commissioned a study which sought (*inter alia*) to assess apparent causes of market

failure in relation to financing of small and medium-sized enterprises, particularly those with high growth potential. The study resulted in a report entitled *Financing Growth: Policy Options to Improve the Flow of Capital to Australia's Small and Medium Enterprises* (Marsden Jacob Associates, 1995, pp. 1-2) which includes amongst its key findings the following:

- Just 10 per cent or so of SMEs aspire to significant growth, and only about 30 per cent of these are willing to employ external equity financing.
- Most growth SMEs seeking external equity financing are not 'investment ready' in that they fail to meet basic requirements for attractiveness to potential external investors.

The report goes on to point out that many smaller growth enterprises in Australia simply do not know what is necessary in order to be investment ready, and therefore fail to attract the external financing they require for growth and development.

Consequently, another study was commissioned by the federal Department of Industry, Science and Tourism that culminated in a report entitled *Investment Readiness Study* (Ernst & Young and Centre for Innovation and Enterprise, 1997, p. viii) which defines investment readiness as 'a state of preparedness and/or willingness to take on an equity investor'. Amongst the three major factors identified as being important to an external investor's assessment of a particular concern's investment readiness is 'the capabilities of management and the internal operations and control present in the business to achieve the identified growth potential' (Ernst & Young and Centre for Innovation and Enterprise, 1997, p. 4). Amongst enterprise weaknesses associated with a lack of investment readiness are 'poor internal systems' and 'lack of management information systems'. Such findings are claimed to not only limit management's ability to successfully manage growth; but to also lead to an information asymmetry which makes it difficult for potential financiers to appropriately assess the risk and return parameters for an investment in the business. In a matrix of investment decision criteria for various investor groups, the following financial reporting considerations are listed:

- Annual budgets and cash-flow forecasts are used.
- Monthly management information is available.
- Financial statements are audited.

Clearly then, timely and relevant financial reporting is a key element of investment readiness amongst growth SMEs in Australia.

Reports like those of the Australian Manufacturing Council in particular have done much to strengthen the resolve of the Australian federal government to stimulate and support domestic and exporting activity by small and medium manufacturing enterprises through targeted assistance programmes. A substantial number of these programmes have included specific attention to aspects of financial management. Of particular significance seem to be financial planning and control, and accessing suitable sources of finance and financial assistance.

A recent example of attention to financial planning and control in SME support in Australia is provided by an Australian industry manual entitled *Financial Management Systems: Selecting Your Business Solution* (Department of Industry, Science and Technology, 1995b, p. viii) which points out that:

Good financial management is one of the essentials for a business to survive and grow.

All businesses, from the smallest to the largest, must establish appropriate systems and procedures to record and analyse the information necessary for effective financial management. Even in the smallest businesses, this increasingly involves the use of computerised financial management information systems.

Further examples of emphasis on financial management of SMEs include a publication entitled *Information to Support an Application for Business Finance* produced by the Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia (1994), in conjunction with the Australian Bankers Association; publication in 1995 of a manual to provide exporters with details of export finance facilities available, the organisations that market them and application methods; and the federal government's Business Equity Information Service supported by Chambers of Commerce and Industry in various States.

Finally, it is most relevant to note that the recently revised national *Competency Standards for Small Business Management* (Small Business Competency Standards Body, 1995) include amongst eight units of competency 'Managing Finances' embracing the following financial management skills:

- Translating financial plans into strategies.
- Implementing financial strategies.
- Monitoring financial performance.
- Exploring opportunities to improve financial performance.

Financial management skills also feature in other units of competency, particularly 'Complete a Business Plan'. It is indicated that performance standards for such skills should reflect the degree of sophistication demanded by a business's position on a continuum which has smaller enterprises exploring world markets at its upper extreme.

## **1.6 About This Research Study**

### **1.6.1 Summary Rationale for the Study**

A good deal of Chapter 1 has been devoted to identifying and describing the contemporary Australian context of the study reported upon in this thesis, with particular emphasis being placed on the apparent significance of financial dimensions of growth in smaller manufacturing enterprises. This discussion, supported by the comprehensive literature reviews presented in Chapters 2, 3 and 4 of the thesis, establish a plausible *raison d'être* for the present research which primarily rests on the following grounds:

- There seems to be little doubt in the prescriptive and research literature concerning the significance to growing small and medium-sized enterprises of improved financial control which can come about (*inter alia*) through more frequent and more comprehensive financial reporting.
- Until now, these matters have received very little specific attention from researchers. As a consequence, they may not be sufficiently well understood by those who study, influence and regulate small and medium-sized enterprises that are growing. Due to inherently fixed set-up and implementation costs, more sophisticated financial reporting practices can be, relatively speaking, a greater burden on smaller enterprises than upon their larger counterparts. This being the case, better insights into the potential costs and benefits of more frequent and more comprehensive financial reporting are vital to theoretically sound and practically justified decisions in this area.
- In the contemporary Australian context, these matters are far from being of trivial importance to those who study, influence and regulate small and medium-sized manufacturing enterprises that are growing. Albeit at some significant cost, sound financial reporting practices are more than likely to play some enabling or facilitating role in successfully achieving smaller enterprise growth and performance enhancement. If this is so, the need for research such as this is underscored.
- As indicated earlier in the chapter, this thesis essentially presents the findings of a large-scale and representative pre-simplification benchmark study that the Corporations Law Simplification Task-Force of the Australian Securities Commission might wish to have had to inform its deliberations prior to making new law on financial reporting by proprietary companies. The findings of the study also suggest the importance of a further post-simplification study for comparative purposes – thus providing an early indication of the impact of the Corporations Law Simplification effort in the area of financial reporting by proprietary companies.

All four of these grounds for undertaking the present study are upheld by the findings and recommendations of recent government sponsored reports on growth in Australian manufacturing SMEs. Particular encouragement is provided by the policy recommendation relating to management transition issues made in the *Emerging Exporters* report (McKinsey & Company, 1993b), quoted earlier in the chapter.

### 1.6.2 Objectives of the Study

It has been argued that the principal research question posed at the outset of the chapter is of considerable significance within the contemporary Australian context. Intended to address this question, the key objectives for the research which forms the basis of the thesis are as follows:

- To describe and attempt to explain the financial reporting practices employed by small and medium-sized manufacturing enterprises legally organised as proprietary companies in Australia.
- To describe and attempt to explain how, if at all, the financial reporting practices of small and medium-sized manufacturing enterprises legally organised as proprietary companies in Australia change as a result of engaging in growth-oriented activities.
- To describe and attempt to explain how, if at all, the financial reporting practices of small and medium-sized manufacturing enterprises legally organised as proprietary companies in Australia impact upon achieved business growth and performance.
- To develop and justify a research agenda for subsequent confirmatory inquiry focused on the role financial reporting practices appear to play in the functioning of small and medium-sized manufacturing enterprises legally organised as proprietary companies in Australia.
- To formulate and justify recommendations relating to financial reporting practices which are directed to those who influence and regulate small and medium-sized manufacturing enterprises legally organised as proprietary companies in Australia.

A full assessment of the extent to which these key objectives are met by the research is presented in Chapter 8 of the thesis.

### **1.6.3 Overview of the Study**

The theoretical framework for the research presented in this thesis is largely derived from neoclassical microeconomics and Austrian economics, with adaptation to accommodate recent strategic management thought. The late 1995 empirical study described in the thesis can be characterised as exploratory in nature and cross-sectional in design. A large random sample stratified disproportionately over enterprise size groupings and ANZSIC codes, and representative on these characteristics of the population of larger Australian manufacturing SMEs, has been sought. The postal survey used a structured questionnaire containing over 50 closed questions focused on enterprise characteristics and performance, and financial management characteristics and practices (including financial reporting practices). Data gathered via the questionnaire are categorical (nominal and ordinal levels) in nature.

Reporting and analysis of the survey findings in the thesis are descriptive, associative and predictive. Analytical techniques employed include descriptive statistics, cross-tabulations, non-parametric measures and tests, non-linear principal components analysis and logistic regression modelling. The exclusive use of non-parametric/distribution free statistical analysis is dictated by the categorical nature and/or irregular distributional properties of the data obtained.

The analytical model for the research described in the thesis, which is developed and justified in the literature review chapters, and that ultimately provides structure to the empirical chapters, is as illustrated in Figure 1.2 on the next page. This analytical schema represents financial reporting practices undertaken in a smaller enterprise as likely to be influenced by certain enterprise and financial management characteristics which together constitute the business context. Business growth and performance outcomes are represented as possibly influenced by the financial reporting practices undertaken in the business. The business context is also likely to influence the growth and performance outcomes directly.

The analytical schema presented can be expressed in mathematical notation as follows for the first key study relationship:

$$R_m = f(E_s, F_t, R_o) \quad \text{Eqn 1.1}$$

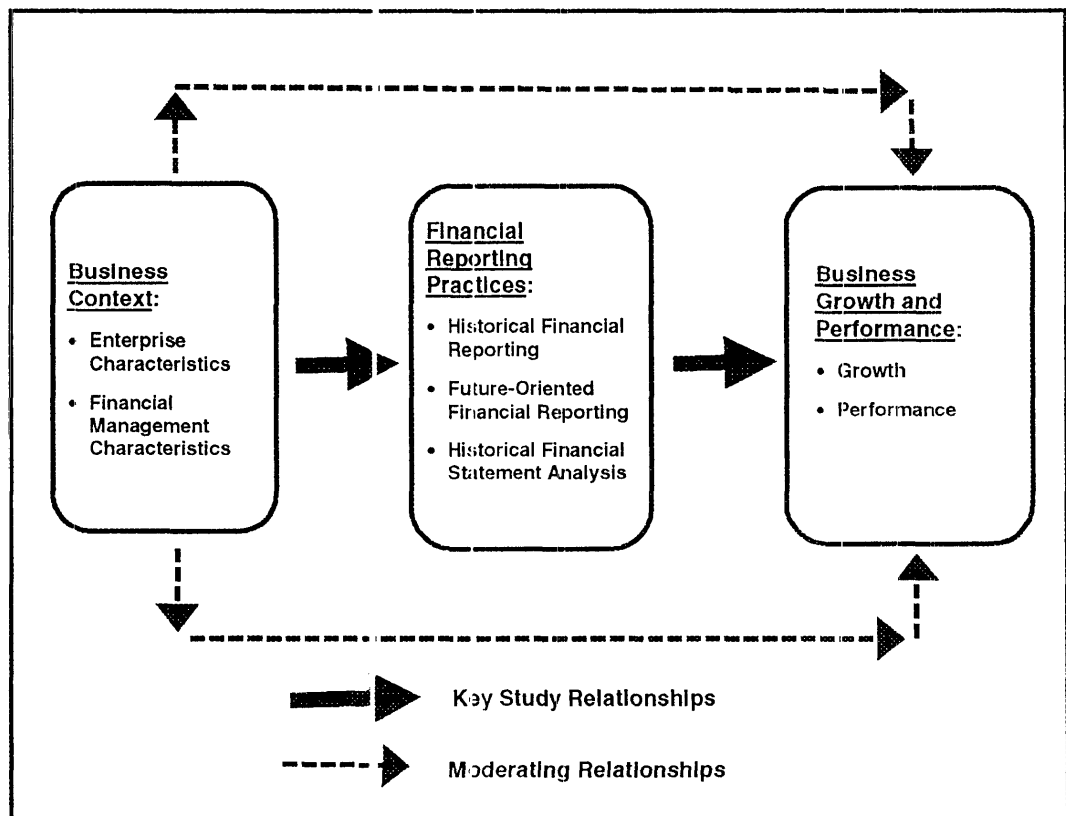
where  $R_m$  = financial reporting practices, notionally dependent variables

$E_s$  = enterprise characteristics, notionally independent variables

$F_t$  = financial management characteristics, notionally independent variables

$R_o$  = other financial reporting practices, notionally covariates

Figure 1.2: Analytical Model for the Research



And for the second key study relationship:

$$Y_p = f(R_m, E_s, F_t, Y_n) \quad \text{Eqn 1.2}$$

where  $Y_p$  = business growth and performance outcomes, notionally dependent variables

$R_m$  = financial reporting practices, notionally independent variables

$E_s$  = enterprise characteristics, notionally covariates

$F_t$  = financial management characteristics, notionally covariates

$Y_n$  = other business growth and performance outcomes, notionally covariates

Whether such dependencies appear to exist in the study sample, and their nature and extent, are of course for the research to discover. Whether they are likely to prevail in the broader population of smaller manufacturers legally organised as proprietary companies in Australia is for the research to infer if this seems justified by the strength and generalisability of its findings.

### 1.7 Structure of the Thesis

The broad structure of the thesis subsequent to this introductory chapter is now outlined. Chapters 1, 2, 3 and 4 together constitute the background to the research study. The theoretical and empirical foundations of the research are established in Chapters 2, 3 and 4 which provide comprehensive and critical reviews of the research literature relevant to the field of study. Chapter 2 is concerned with describing and explaining what is presently known regarding the process of growth in small and medium-sized business enterprises; and also with what is known about the impact of this process upon achieved business growth and performance. Chapter 3 examines the institutional context and theoretical framework for financial reporting by smaller enterprises. Chapter 4 deals with existing knowledge of SME financial reporting practices and their role in growth; and also with what is known about the impact of financial reporting practices on achieved business growth and performance.

The design and findings of the research described in the thesis are covered in Chapters 5, 6 and 7. The broad conceptual and methodological foundations of the study, along with a detailed description and justification of the particular approach and method adopted, are detailed in Chapter 5. The descriptive findings of the research are presented in Chapter 6, and these findings are analysed in some depth in Chapter 7.

The outcomes of the research study described in the thesis are the subject of Chapter 8 which summarises the findings of the study, explains its limitations and details the study's claimed contributions to knowledge in the area. Chapter 8 also provides recommendations arising from the study which are directed to various parties with a presumed interest in it. The thesis closes with a listing of the literature relied upon in the study and various appendices containing supporting material for the research.

### 1.8 Chapter Review

This opening chapter of the thesis has sought to establish that the issue of the facilitating role possibly played by sound financial reporting practices in the successful growth and performance enhancement of smaller manufacturing enterprises is important. This appears especially so in the context of current attempts by the Australian federal and State/Territory governments to stimulate and support small and medium-sized manufacturers. The issue is believed to be of considerable significance to a variety of organisations, professionals and stakeholders who seek to study, influence and regulate smaller manufacturing enterprises that are growing.

The chapter has endeavoured to translate the broad proposition in the previous paragraph into a justified, scholarly basis for the research study this thesis seeks to describe. The justification rests mainly on the paucity of prior research in the area, causing the matters the core issue raises to be poorly understood; and also the likely value of the findings to those who would benefit most from a better understanding of these matters. The scholarly framework for the study has been established in specifying the principal research question as follows:

Which enterprise and financial management characteristics seem to most influence financial reporting practices adopted in small and medium-sized manufacturing enterprises legally organised as proprietary companies in Australia; and what impact, if any, do these financial reporting practices appear to have on achieved business growth and performance in such concerns?

Key study objectives have been formulated which are directed towards answering this research question, and the broad design of the study has been outlined.