CHAPTER 8: SUMMARY AND CONCLUSIONS OF THE RESEARCH STUDY

8.1 Introduction

This eighth and final chapter of the thesis is primarily concerned with summarising what has been found in this study regarding financial reporting practices adopted in small and medium-sized manufacturing enterprises legally organised as proprietary companies in Australia. It also attempts to explain the meaning and implications of the research findings for those with scholarly and/or policy interest in the field. Ultimately, the chapter seeks to establish that, taken as a whole and despite its acknowledged limitations, the thesis is worthy of the award of a doctorate by research.

The chapter first summarises what has been discovered about the comprehensiveness of financial reporting undertaken for internal financial management purposes in the SMEs investigated. Findings of the research on the impact of enterprise growth upon financial reporting practices are subsequently outlined. The apparently very limited influence of financial reporting practices upon achieved business growth and performance outcomes is then highlighted. After a full statement of the limitations of this investigation, attention turns to developing and justifying a research agenda for confirmatory inquiry focused on the role financial reporting practices appear to play in the functioning of smaller manufacturing enterprises. Next, the chapter concerns itself with formulating and justifying recommendations relating to financial reporting practices directed to those who influence and regulate such concerns. Finally, the contributions of this thesis to theory development, to methodological development and to the extension of empirical knowledge in its field are detailed.

8.2 Summarising Findings of the Study

8.2.1 Financial Reporting Practices

This sub-section of the chapter is concerned with confirming achievement of the first key objective of the research: describing and attempting to explain the financial reporting practices employed by small and medium-sized manufacturing enterprises legally organised as proprietary companies in Australia. In Chapter 6 of the thesis, it is indicated that the sample used in this research approximates the larger end of the manufacturing SME spectrum and includes business concerns for which the extent and frequency of historical and future-oriented financial reporting undertaken may be important matters. Data collected for a range of financial reporting variables have been presented which, when compared to other Australian and international research findings in the area, reveal that financial reporting practices amongst the collaborating businesses are of a high standard and are very encouraging from a financial management viewpoint.

In Chapter 3 of the thesis, it is suggested that this research tests, in an exploratory sense, the veracity of two competing theoretical paradigms for understanding and explaining financial reporting in smaller business enterprises:

- That provided by neoclassical microeconomics which is reflected in modern finance theory and which represents mainstream thought on financial management of businesses, including those that are small or medium-sized. According to this paradigm, historical and future-oriented financial reports, and analysis and interpretation of such reports, have considerable decision usefulness.
- That provided by Austrian economics which has not been widely supported to date, but which is assuming greater significance as small and medium-sized enterprises become more central to scholarly and policy-related deliberations. According to this paradigm, historical and future-oriented financial reports, and analysis and interpretation of such reports, have little decision usefulness.

Differences between these paradigms are most likely to be reflected in what is discovered on use of financial reports for internal financial management purposes by owner-managers and managerial employees. On balance, the evidence is that the neoclassical microeconomics position is more accurately reflected in the financial reporting practices of the SMEs investigated in this study than that of Austrian economics.

In Chapter 7 of the thesis, it is indicated that there are statistically significant relationships between the comprehensiveness of financial reporting practices amongst respondents to the *Best Financial Practice* survey and the majority of enterprise and financial management characteristics used in this research to capture the business context. The magnitude of the associations with development orientation, enterprise size in employment terms and financial reporting climate suggests these as the most important influences on observed financial reporting practices. Subsequent logistic regression modelling described in Chapter 7 reveals that the comprehensiveness of financial reporting practices is mainly impacted by five groupings of explanatory factors:

- Development orientation – reflecting how forward looking enterprise management is, what degree of commitment there is to growth, including through exporting, and enterprise size. It might reasonably be expected that enterprise development will be more evident where there are written organisational goals, there are plans for business growth in the ensuing two to three years, a written business plan extending beyond 12 months into the future exists, a formal financial plan or budget has been prepared, the fixed asset investment planning horizon is longer, the enterprise presently exports and may have plans for further export market development, and the enterprise is larger in employment terms. The logistic regression models reveal that the comprehensiveness of financial reporting practices increases with increasing development orientation, which is the direction of influence anticipated for this enterprise characteristic on the basis of the background literature reviewed earlier in the thesis.

- Owner-management – reflecting the degree to which owners have retained for themselves the responsibility for management of their concerns. It might reasonably be expected that owner-management will diminish as SMEs grow and professional managers are appointed for day-to-day operational support, allowing the owner-managers' role to become more strategic in its emphasis. The presence of an external director on the Board also becomes more likely as small and medium-sized enterprises grow, especially if growth has been financed with external funds. The logistic regression models reveal that the comprehensiveness of financial reporting practices necessarily increases with decreasing day-to-day involvement of owner-managers; and is possibly also influenced by the increasing likelihood of there being an external director on the Board. Again, this is the direction of influence anticipated for this enterprise characteristic on the basis of the background literature reviewed earlier in the thesis.
- Technological complexity – reflecting differences in the complexity of technology between respondent manufacturing concerns. It might reasonably be expected that, as manufacturing moves towards a wider product range with greater numbers of components production technology tends to become more complex and imposes greater managerial demands. The logistic regression models reveal that the comprehensiveness of financial reporting practices decreases with increasing technological complexity. This direction of influence is the reverse of that anticipated for this enterprise characteristic on the basis of the background literature reviewed earlier in the thesis. The only explanation that can be offered for this finding is the possibility that owner-managers of SMEs utilising advanced technologies tend to rely on technical indicators of business position and performance, rather than on the financial measures which appear in accounting reports.
- External advice – reflecting the degree of dependence amongst respondent enterprises upon outside professionals, usually public accountants, for advice on a range of financial matters. It might reasonably be expected that use of financial reports by owner-managers and managerial employees will be less evident where an external adviser is being paid to provide financial oversight of the business. The logistic regression models reveal that the comprehensiveness of financial reporting practices decreases with increasing dependence on external financial advisers. Remembering that smaller enterprises frequently cannot afford to employ their own internal finance staff, and therefore tend to be more dependent on outside financial advice, this is the direction of influence anticipated for this financial management characteristic on the basis of the background literature reviewed earlier in the thesis.
- Financial reporting climate – reflecting how conducive the climate in the manufacturing SMEs under study is towards financial reporting for internal

financial management purposes. It might reasonably be expected that financial reporting to owner-managers and managerial employees will be less evident where there is little or no financial reporting to financiers, there is little contact with financiers outside of formal financial reporting, there is no imperative to produce externally audited financial statements, there are relatively few internally employed finance staff, and those who are employed have little recent training on accounting software and in financial and management accounting. The logistic regression models reveal that the comprehensiveness of financial reporting practices increases with increasing conduciveness of the financial reporting climate. This is the direction of influence anticipated for this financial management characteristic on the basis of the background literature reviewed earlier in the thesis.

Of the variable groupings identified, development orientation and financial reporting climate seem to be most influential upon the comprehensiveness of financial reporting practices of respondent enterprises.

8.2.2 Growth and Financial Reporting Practices

This sub-section of the chapter is concerned with confirming achievement of the second key objective of the research: describing and attempting to explain how, if at all, the financial reporting practices employed by small and medium-sized manufacturing enterprises legally organised as proprietary companies in Australia change as a result of engaging in growth-oriented activities.

In Chapter 6 of the thesis, it is reported that nine of 11 variables reflecting financial reporting to owner-managers and managerial employees of respondent enterprises in the *Best Financial Practice* survey show statistically significant associations with enterprise size in employment terms. In all cases, financial reporting practices appear more advanced in larger concerns. In Chapter 7 of the thesis, it is indicated that, in an overall sense, financial reporting practices are more comprehensive in larger concerns in employment terms; and that a statistically significant difference in the comprehensiveness of financial reporting practices exists between small enterprises and medium-sized enterprises, with these practices being more extensive in medium-sized concerns.

While enterprise size in employment terms is not separately included in the logistic regression models for the comprehensiveness of financial reporting practices presented in Chapter 7, the number of employees does nevertheless influence the models through its substantial association with development orientation. Recall that development orientation is the business context characteristic with greatest explanatory power in the models. To the extent that development orientation represents a disposition towards business growth, this is the most persuasive argument for a linkage between the comprehensiveness of financial reporting and increasing enterprise size. Thus, if it is believed that cross-sectional findings on financial reporting practices in manufacturing SMEs of various sizes can provide some insight into possible changes in financial reporting practices as concerns like these grow, there is undoubtedly a strong suggestion that financial reporting practices increase in sophistication as smaller manufacturing enterprises get bigger in employment terms.

Looking further, the logistic regression models developed in this research for the comprehensiveness of financial reporting expose various other causal influences at work as manufacturing SMEs grow:

- The models reveal that the comprehensiveness of financial reporting practices increases with decreasing day-to-day involvement of owner-managers; and is possibly also influenced by the increasing likelihood of there being an external director on the Board. It is indicated in Chapter 7 of the thesis that owner-management is statistically related to enterprise size in employment terms; and that a statistically significant difference in owner-management exists between small enterprises and medium-sized enterprises. Initially, the extent of owner-managership seems to decrease with increasing enterprise size in employment terms; but then owner-managership increases quite markedly for medium-sized concerns. The reason for this pattern is not immediately evident. Overall though, daily participation in management by owner-managers is likely to diminish as SMEs grow, and having an external director becomes more likely if growth has been financed with external funds. Both influences could lead to more extensive financial reporting being undertaken for financial management and accountability purposes.
- The models reveal that the comprehensiveness of financial reporting practices increases with decreasing dependence on external financial advisers. It is indicated in Chapter 7 of the thesis that dependence on external financial advice is statistically lower in larger enterprises in employment terms; and that a statistically significant difference in dependence on external financial advice exists between small enterprises and medium-sized enterprises, with the dependence being lower in medium-sized concerns. As SMEs grow, it is common for them to employ their own bookkeepers and/or accountants and rely less upon public accountants. Responsibility for financial management becomes increasingly more internalised within the business, and financial reporting to support this task is likely to become more extensive.
- The models reveal that the comprehensiveness of financial reporting practices increases with increasing conduciveness of the financial reporting climate. It is indicated in Chapter 7 of the thesis that the financial reporting climate is statistically better in larger enterprises in employment terms; and that a statistically significant difference in financial reporting climate exists between small enterprises and medium-sized enterprises, with the climate being better in

medium-sized concerns. To the extent that SME growth is externally funded, more extensive financial reporting to financiers becomes likely, and it is possible that owner-managers and managerial employees will make use of such reports in internal financial management.

Further evidence on the comprehensiveness of financial reporting practices and enterprise growth, this time in terms of past growth in annual sales turnover and anticipated future sales growth, is presented in the following sub-section of the chapter.

8.2.3 Business Growth and Performance

This sub-section of the chapter is concerned with confirming achievement of the third key objective of the research: describing and attempting to explain how, if at all, the financial reporting practices employed by small and medium-sized manufacturing enterprises legally organised as proprietary companies in Australia impact upon achieved business growth and performance.

In Chapter 7 of the thesis, it is indicated that the comprehensiveness of financial reporting practices is statistically greater in smaller enterprises responding to the *Best Financial Practice* survey that have recently grown more strongly in sales revenue terms. Furthermore, the comprehensiveness of financial reporting practices is statistically greater amongst respondents that anticipate growing more strongly in sales revenue terms. Together, these findings establish that the comprehensiveness of financial reporting practices has some potential as an explanatory factor for past and anticipated future sales growth in manufacturing SMEs.

The explanatory factors for past and anticipated future sales growth that have emerged in the logistic regression models presented in Chapter 7 of the thesis seem to make business sense and are not inconsistent with prior scholarly knowledge in the area. Admittedly, the goodness-of-fit and classification success of the past sales growth models are discouraging; and those for anticipated future sales growth are only better because they have the advantage of being able to include immediate past experience of sales growth amongst the independent variables used. Most importantly though, despite the statistically significant bivariate associations noted in the previous paragraph, the comprehensiveness of financial reporting practices does not feature as an independent variable in any of the multivariate sales growth models.

In Chapter 7 of the thesis, it is indicated that the comprehensiveness of financial reporting practices is statistically greater in smaller enterprises responding to the *Best Financial Practice* survey that have higher annual sales revenues. However, the comprehensiveness of financial reporting practices appears to be statistically unrelated to profitability relative to that of competitors. Finally, the comprehensiveness of financial reporting practices seems to be statistically related in a complex manner to the recency of an unexpected liquidity crisis. Together, these findings establish that the comprehensiveness of financial reporting practices has some limited potential as an explanatory factor for business performance in manufacturing SMEs.

The explanatory factors for enterprise performance that have emerged in the logistic regression models presented in Chapter 7 of the thesis seem to make business sense and are not inconsistent with prior scholarly knowledge in the area. The goodness-of-fit and classification success of the annual sales turnover models are encouraging; but those for profitability compared to that of competitors and for the recency of having experienced an unexpected liquidity crisis are less so. As with the sales growth models though, the comprehensiveness of financial reporting practices does not feature as an independent variable in any of the business performance models.

As suggested in Chapter 7 of the thesis, it is important to view with an appropriate perspective what appear to be disappointing or negative results of logistic regression modelling of business growth and performance amongst SMEs responding to the *Best Financial Practice* survey. First, given the inherently multifactorial nature of business activity and the results of prior research in the area reviewed in Chapter 4 of the thesis, it would, in fact, have been somewhat surprising to see the comprehensiveness of financial reporting practices appearing amongst the statistically significant independent variables in the logistic regression models. Notice that the study variables FRCLIMAT and FINACCNT reflecting (*inter alia*) the extent of financial reporting to financiers are not amongst the statistically significant independent variables either. Recall that the principal research question in this study is symmetric in asking what impact, *if any*, financial reporting practices appear to have on achieved business growth and performance. It would seem that financial reporting practices exert a minor, although not entirely unimportant, influence on some growth and performance outcomes – a now supportable finding not without value in terms of understanding the dynamics of growth in small and medium-sized enterprises.

A second point to bear in mind when appraising the modelling of business growth and performance carried out is that, as particularly the prior research summarised in Chapter 2 of the thesis indicates, dependable means of 'picking winners' – that is, discovering SMEs with strong growth and performance potential – have escaped researchers and policy-makers in many countries up to this time. The models that have emerged in this research are, at least, no worse than those proffered in many other published and unpublished studies. Remember also that devising ways to pick winners amongst smaller manufacturing concerns in Australia is not included in the principal research question for this investigation, or in the key study objectives stemming from it. This does not mean, of course that some light cannot or should not be shed on this important matter by the present research.

8.3 Limitations of the Study

Inevitably, the quality of any research study in terms of its reliability and validity is strongly influenced by the many practical decisions that must be made during its course. The need for compromise is most often created by limited access to scarce resources of both a financial and a non-financial nature. In particular, and despite its high ambitions, doctoral research is notoriously constrained by resource limitations. Thus, it is almost always flawed to a lesser or to a greater degree. It is evident that the present research is no exception to this generalisation.

The most significant limitations of this scholarly investigation stem from the broad methodological choices that have been made, with outcomes summarised as follows:

- The study is exploratory in its orientation.
- Temporal design of the study is cross-sectional.
- Secondary data is employed in the study.
- The study accesses informants through voluntary responses to a postal survey.
- Data is gathered using a self-administered questionnaire.
- Non-parametric/distribution free techniques are exclusively used in description and analysis of the data.

Strengths and weaknesses introduced to the research by these various methodological characteristics are considered in some detail in Chapter 5 of the thesis, and they are not restated here.

More specific limitations imposed by the approach adopted in the investigation, and which deserve particular mention, are:

- In considering significant aspects of the business context, the study concentrates on factors largely internal to the small and medium-sized manufacturing enterprises investigated and does not capture very much concerning their external environment. This is a significant overall limitation of the research that cannot be remedied, given the inquiry's reliance on secondary data.
- The internal business functions of greatest concern in the study are financial management and, to a lesser degree, strategic management. Other functions such as production management, marketing management and personnel management are virtually neglected. This is a significant overall limitation of the research; although, to the extent that strategic management subsumes all other business functions, this weakness may be ameliorated somewhat.
- The study has concentrated solely upon general purpose financial reports defined as more or less standardised financial statements as to content and format which can serve a variety of decision purposes both within and without a business. Specifically, the research has focused on the three most widely recognised, approved and accepted general purpose financial reports or statements relating to a business enterprise's affairs in an overall sense: the balance sheet, the profit and loss statement and the cash-flow statement. Both historical and future-

oriented forms of these financial statements, and means for analysis and interpretation of such statements, have been of interest. Because of their almost unlimited diversity, special purpose financial reports or statements of the type usually advocated for cost and management accounting purposes in business segments, whether historical or future-oriented, have not been considered. However, it is entirely possible that, given their freedom to choose whatever form of financial reporting best serves their needs, SME owner-managers may prefer to obtain and use special purpose/non-standard financial reports for internal financial management. Offering no accommodation to this discretion in financial reporting imposes recognised limitations on the generalisability of the findings of the research.

- Every effort has been made to fully describe the individual historical and future-oriented financial reporting practices of interest in this study. However, practical considerations have dictated use of an overall index of the comprehensiveness of financial reporting practices in logistic regression modelling. While defensible in the circumstances, this procedure has prevented separate modelling of historical and future-oriented financial reporting practices. In view of the finding by Hutchinson *et al.* (1975), Ray (1980a, 1980b), Hutchinson *et al.* (1981), Ray & Hutchinson (1983, 1985) and Hutchinson & Ray (1986) that use of the two types of financial reporting changes differentially during SME growth, this is a significant limitation of the predictive modelling aspect of the present research.
- It has not been possible to include enterprise age in description and analysis of the data employed in the study. Having established, especially in Chapter 2 of the thesis, the potential explanatory importance of enterprise age to the research, this variable is not included in empirical evidence presented in Chapters 6 and 7. As explained in Chapter 6, the question intended to establish enterprise age in the instrument used in the *Best Financial Practices* survey is sufficiently flawed that responses to it are judged to be unusable. In view of the inclusion of enterprise age as an explanatory variable in prior logistic regression modelling of financial reporting practices conducted by Holmes & Nicholls (1989), Holmes *et al.* (1991a) and McMahon *et al.* (1992a, 1992b, 1994a), this is a significant overall limitation of the research.
- Logistic regression modelling of financial reporting practices previously conducted by Holmes & Nicholls (1989) indicates that whether or not owner-managers have sought management training since starting up their enterprises is a significant explanatory variable. Furthermore, Holmes *et al.* (1991a) have discovered whether or not owner-managers have had formal post-secondary education to be important. Finally, McMahon *et al.* (1992a, 1992b, 1994a) include whether or not owner-managers have had useful prior experience in financial management as an independent variable in their modelling. Unfortunately, the instrument used in the

Best Financial Practices survey does not contain questions relating to owner-manager education/training/experience, and this line of inquiry therefore could not be pursued. This is a significant overall limitation of the research.

- Logistic regression modelling of financial reporting practices previously conducted by Holmes *et al.* (1989) suggests that legal structure and industry sector are significant explanatory variables. Holmes *et al.* (1991a) confirm industry sector to be important. For reasons given earlier in the thesis, this study has deliberately focused upon the financial reporting practices of proprietary companies operating in the manufacturing sector. This imposes limitations on the generalisability of the findings of the research that are accepted.
- In the present exploratory context, the classification success of logistic regression models developed for financial reporting practices and business growth and performance outcomes has been evaluated only for the original development/ learning/modelling sample. No external validation has been undertaken using data from an entirely separate source, because such data have not been available. This is a significant limitation of the predictive modelling aspect of the research.

8.4 Recommendations Arising From the Study

8.4.1 Smaller Enterprise Scholarship

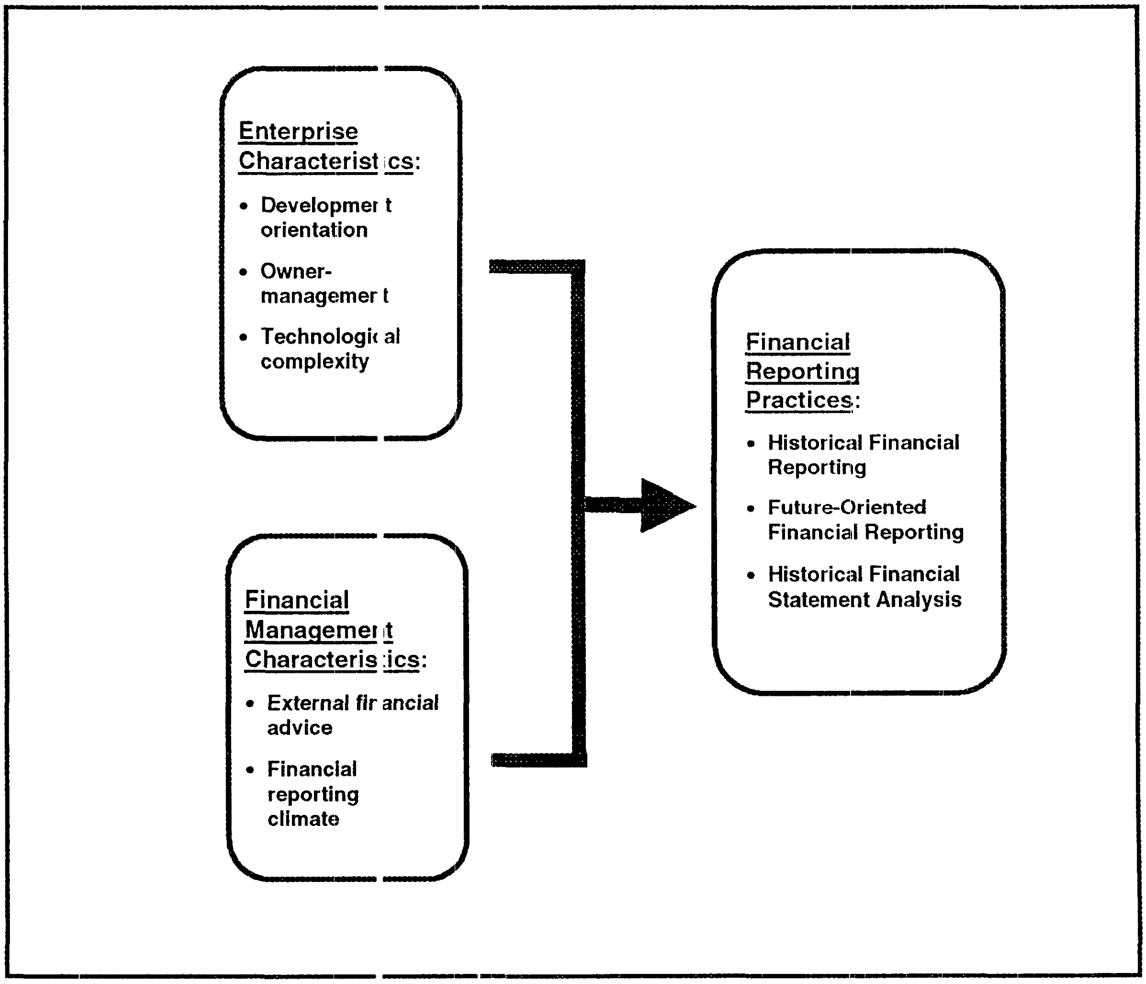
This sub-section of the chapter is concerned with meeting the fourth key objective of the research: developing and justifying a research agenda for confirmatory inquiry focused on the role financial reporting practices appear to play in the functioning of small and medium-sized manufacturing enterprises legally organised as proprietary companies in Australia.

The first part of the principal research question for the present investigation considers which enterprise and financial management characteristics seem to most influence financial reporting practices adopted in growing SMEs. An analytical schema for subsequent confirmatory research that derives strictly from the findings of this exploratory study is illustrated in Figure 8.1 on the next page. In following this schema, it would obviously be important to explicitly consider interactions between variables within each grouping, as well as influences between groupings. Note that enterprise size in employment terms features indirectly in the schema through its substantial association with development orientation.

Specific research propositions that should be examined in further confirmatory inquiry, following the schema presented above, include the following:

- Development orientation – the comprehensiveness of financial reporting practices undertaken for internal financial management purposes in small and medium-sized enterprises increases with increasing development orientation in such concerns.

Figure 8.1: Modelling Financial Reporting Practices in Subsequent Research



- Owner-management – the comprehensiveness of financial reporting practices undertaken for internal financial management purposes in small and medium-sized enterprises increases with decreasing day-to-day involvement of owner-managers in their concerns.
- Technological complexity – the comprehensiveness of financial reporting practices undertaken for internal financial management purposes in small and medium-sized enterprises decreases with increasing technological complexity within such concerns.
- External financial advice – the comprehensiveness of financial reporting practices undertaken for internal financial management purposes in small and medium-sized enterprises decreases with increasing dependence on external financial advisers by such concerns.
- Financial reporting climate – the comprehensiveness of financial reporting practices undertaken for internal financial management purposes in small and medium-sized enterprises increases with increasing conduciveness of the financial reporting climate within such concerns.

With a view to overcoming some of the limitations of the present study recognised earlier in this chapter, and also extending the inquiry in certain important respects, serious consideration should be given to including in subsequent confirmatory investigation a number of variables not specified directly or indirectly in Figure 8.1, but which other research suggests may be important. Amongst these could be:

- Enterprise age, either in its own right or to be used along with enterprise size as a means for classifying businesses studied into appropriate stages of some enterprise life-cycle model.
- Owner-manager characteristics such as background education, management training and business experience - particularly concerning financial management of small and medium-sized enterprises.
- Separate consideration of historical and future-oriented financial reporting practices in order to explore for differences in patterns of their use as SMEs grow.
- Extension of historical and future-oriented financial reporting practices studied to include special purpose financial reports that may be used by smaller enterprise owner-managers for internal financial management.
- Recent history of classification of the businesses studied as a small or a large proprietary company under the simplified financial reporting provisions of the Australian Corporations Law.

Thought could also be given to the possibility of widening future confirmatory research to industry sectors other than manufacturing, and to small and medium-sized enterprises other than those legally organised as proprietary companies.

In many methodological respects, further confirmatory inquiry could usefully parallel the investigation reported by Hutchinson *et al.* (1975), Ray (1980a, 1980b), Hutchinson *et al.* (1981), Ray & Hutchinson (1983, 1985) and Hutchinson & Ray (1986). As indicated in Chapters 2 and 4 of the thesis, that study seeks (*inter alia*) evidence on the manner in which financial reporting systems and practices appear to change as a result of smaller enterprises experiencing growth, and attempts to contrast these circumstances with those in non-growth concerns with otherwise similar characteristics. In these aspirations, there is much common ground with the proposed confirmatory extension of the present study. Resources permitting, new primary evidence on financial reporting practices in Australian SMEs might therefore be gathered in a manner similar to that employed in the earlier United Kingdom investigation:

- The research should compare and contrast financial reporting practices undertaken in matched samples of growth and non-growth smaller enterprises. Matching may be required on a number of bases including legal structure, industry sector or sub-sector, technological complexity, computer usage and dependence on external financing.

- The research should adopt a longitudinal time frame. As indicated earlier in the thesis, issues surrounding growth and/or development in SMEs are most appropriately studied in a longitudinal manner.
- The research should obtain evidence on financial reporting practices through in-depth interviews with owner-managers, managerial employees and internal and external financial advisers using a semi-structured interview schedule; and through permitted access to business records, example financial reports, etc.
- The research should seek to ascertain and reveal the actual decision processes involving use of financial reports by owner-managers and managerial employees for internal financial management in the businesses studied.

In order to meet the confirmatory ambitions of the proposed research, relatively large matched samples of growth and non–growth enterprises (possibly upwards of 100 businesses in each sample) would need to be secured, perhaps through collaboration with an Australian federal government programme for stimulation and support of growth amongst small and medium-sized enterprises.

On the basis of the discouraging results of this study, and in view of similar findings of earlier investigations such as those of Thomas & Evanson (1987), Capon *et al.* (1990) and McMahon & Davies (1991a, 1991b, 1992a, 1992b, 1994) in particular, further scholarly inquiry into the possible impact of financial reporting practices upon business growth and performance outcomes in small and medium-sized enterprises cannot be recommended at this time. In other words, it is believed that consideration of the second part of the principal research question for the present investigation should, for the time being, be discontinued. Before this line of inquiry is resumed, confirmatory study of the type just outlined needs to be conducted so that a much clearer picture is available of the decision processes involving use of financial reports for internal financial management purposes in growing SMEs. Furthermore, a great deal more must be known about broader factors associated with smaller enterprise success. As already noted in the thesis, the dynamics of growth and development in such concerns are still far from being fully understood by researchers in the field.

8.4.2 Smaller Enterprise Policy-Making

This sub-section of the chapter is concerned with meeting the fifth key objective of the research: formulating and justifying 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. Comments and recommendations are directed to politicians and officials who make government policy impacting upon SMEs, and also to those in the Australian professional accounting bodies who provide expert guidance to government regarding financial reporting regulation.

If the simplified Australian Corporations Law relating to financial reporting by proprietary companies must be accepted in more or less in its present form, then a particularly important public interest issue is the appropriateness or otherwise of the criteria it specifies for distinguishing between small and large proprietary companies. The point has been made in the thesis that the employment criterion (fewer than the equivalent of 50 full-time employees) is low relative to various employment benchmarks for manufacturing concerns now in use. This means that many smaller manufacturers organised as proprietary companies – their most likely legal form – will need to rely on the other two size-related criteria to avail themselves of the less onerous financial reporting demands on small proprietary companies. In reality, given the capital intensive nature of manufacturing and the need to operate at reasonable scale, it is highly likely that many small and most medium-sized manufacturers will be large proprietary companies according to the Corporations Law as it now stands. If not relieved by the grandfathering provisions of the *First Corporate Law Simplification Act 1995*, such businesses may seek to invoke the reporting entity concept to ameliorate the financial reporting demands they face, but these remain significant compared to those previously imposed on exempt proprietary companies. The Australian Securities Commission has been directed to review the criteria for small and large proprietary companies, and the new financial reporting provisions which have been summarised in the thesis, by 1998. The findings of this research could usefully inform such a review.

Reflecting on what this study has revealed, the first and perhaps most important point to make is that the generally high standard of financial reporting practices amongst the collaborating businesses suggests that there is little justification for policy-makers and their advisers to preoccupy themselves with the quantum of financial reporting undertaken in such concerns. Earlier in the thesis, it is indicated that Section 9.3 of the *Small Business Guide* forming Part 1.5 of Chapter 1 of the *First Corporate Law Simplification Act 1995* closes as follows (CCH Australia, 1996, p. 3392):

> Although the Corporations Law itself may not require a small proprietary company to prepare accounts except in the circumstances mentioned, the company may need to prepare the accounts for the purposes of other laws (for example, income tax laws). Moreover, good business practice may also make it advisable for the company to prepare the accounts so that it can monitor and better manage its financial position.

The smaller proprietary companies studied in this investigation, undoubtedly with the encouragement or compulsion of external financiers, financial advisers and taxation authorities, appear fully cognisant of the need to implement sound financial reporting practices. This being the case, it seems futile for the Corporations Law and/or promulgated accounting standards to direct that such businesses should undertake more or less financial reporting, depending on somewhat arbitrary circumstances. In many respects, financial reporting relief under the Corporations Law and the differential reporting provisions of accounting standards is meaningless for such businesses.

There are more pressing and arguably more effective imperatives on development oriented SMEs to undertake comprehensive financial reporting on their affairs. There is ample evidence in this research to indicate that external financiers to such businesses have been very successful in securing the level of financial reporting (including independent audits) that they require. The powerful imperative resting with the Australian Taxation Office obviously cannot be overlooked. On the issue of the effectiveness of the statutory imperative, recall that past evidence of significant levels of non-compliance by proprietary companies with financial reporting provisions of the Corporations Law has been noted in the thesis. Regarding the law as it now stands in Australia, perusal of Table 3.1 in this thesis (reproduced from Australian Accounting Research Foundation, 1996) suggests that it is a moot point whether simplification or obfuscation has been the true consequence of law reform in the area. This point is more fully argued in a recently published paper based on part of Chapter 3 of the thesis (McMahon *et al.*, 1997).

The case that has been put on regulation of the quantum of financial reporting undertaken by proprietary companies should not be construed to extend to publicly listed companies. There are inevitably a greater number of possibly less expert and certainly relatively less influential external stakeholders in such concerns, the protection of whose interests seems to be best served by regulation of the quantum of financial reporting through statute, the stock exchange and the professional accounting bodies. In the case of proprietary companies, however, the fewer external stakeholders are probably more expert in matters relating to financial reporting and are also likely to be in a position to demand the financial reporting they need, using the imperative of potential denial or removal of financial support. Even SMEs that are creditors to other smaller concerns hold the ultimate sanction of withdrawal of credit facilities if the financial information they require to asses their risk exposure is not forthcoming.

Thus, the real issues for policy-makers and their expert advisers in relation to financial reporting by small and medium-sized proprietary companies would appear to be:

- Format – essentially, whether or not promulgated accounting standards should be applied to financial reports of smaller proprietary companies. It is difficult to argue against the proposition that greater uniformity in financial reporting practices considerably enhances understanding of the contents of financial statements. However, as far as SMEs legally organised as proprietary companies are concerned, two caveats need to recognised. The first is that adherence to accounting standards is not a costless imposition and, as pointed out earlier in the thesis, because of their inherently fixed nature these costs tend to fall more heavily on smaller businesses. The second caveat is that many of the commercial complexities that prevail in larger enterprises, and for which specific accounting standards are undoubtedly essential, do not exist in smaller concerns. The obligation to small and medium-sized enterprises would therefore seem to be to limit the number of accounting standards to a necessary minimum, and to constrain these to being relatively straightforward and acceptably flexible in their application. More recent developments in the financial reporting provisions of the Corporations Law noted in Chapter 3 of the thesis appear to be encouraging in these respects.

- Audit – whether or not an independent external audit should be required for financial reports of smaller proprietary companies. Such external scrutiny is frequently seen by SME owner-managers as an unwarranted intrusion on the privacy of their business affairs. This privacy issue is mainly addressed in the next point. It is undoubtedly also the case that the managerial benefits of independent audits are not well understood in smaller concerns, so that their not inconsiderable cost seems exorbitant when weighed against other benefits which are seen as wholly accruing to free riders external to the business. And yet, the findings of this research reveal that up to one-half of the respondents have, at some time, employed an external financial adviser to conduct an audit. It is suspected that this is mainly at the insistence of external financiers in order to overcome information asymmetry, and to provide some assurance on the veracity of information submitted in justification of applications for finance. Of course, It may also be the case that external audits have been imposed on large proprietary companies by the Corporations Law.

  The suggestion is made that independent audit of the financial statements of smaller proprietary companies should only be required by the Corporations Law in circumstances where, for some legal reason(s), inquiry into the affairs of such businesses by the Australian Securities Commission (or some other legal agency) seems justified and is imminent. This is a much simpler and far less costly arrangement than the system of requirements and exemptions that is presently causing so much confusion amongst small and medium-sized proprietary companies and their financial advisers. External financiers to these businesses would remain free to demand the reassurance of an independent audit if this is considered a prudent and commercially viable condition of providing funds. External audits should remain a voluntary inclusion in corporate governance arrangements between owner-managers.

- Privacy – whether or not financial reports of smaller proprietary companies should become available on the public record. This is clearly the most contentious issue from the viewpoint of many SME owner-managers who cling to the idea that their businesses are, by another name, 'private' companies – seemingly regardless of the extent to which they seek external financial support for them. There is a firm belief that formal financial reporting represents a threat to privacy and competitive advantage if the information presented should, under any circumstances, become available to outside parties. At the extreme, there may be deliberate efforts to conceal financial information from parties that have genuine and possibly legally enforceable rights of access to such information. In fact, the Corporations Law as it stands fully respects and upholds the privacy of financial information on smaller proprietary companies as long as they do not seek substantial external financial support. However, when external funds are sought in significant quantities, the law appears to move to the opposite extreme and require that a great deal of commercially sensitive and costly financial information is put on the public record where an owner-manager's worst fears may be realised.

The question can be posed whether, in fact, there is not some acceptable middle ground on this matter. This would necessitate recognition by SME owner-mangers that one not unreasonable cost of seeking external financial support is the need to surrender some privacy to those from whom funds are sought. It should be clear that financiers cannot responsibly provide funds without some effort being made to ensure that the risks involved are acceptable. Sound commercial practice suggests that this may entail preparation of a business plan, regular financial reporting to the financiers, and possibly independent audits of the business plans and/or financial reports. At least the information becoming available outside the business would be in limited circulation and measures could be undertaken to ensure that this information remains confidential to the parties involved.

Financiers would, of course, need to ensure that they are abreast of best practice in financing activities, do not seek more information than they really need to assess their risk exposure, do not pass on the costs of their own inefficiencies and/or lack of expertise in smaller enterprise lending, and do not impose other unacceptable burdens on the businesses they support such as excessive collateral demands. It may be that such suggestions are too simplistic. However, perceived market failure between small and medium-sized proprietary companies and the Australian financial sector, prompting legislative intervention, clearly leads to very high costs for all involved.

8.5 Study's Contributions to Knowledge

The rules under which this thesis is submitted for examination require that the work upon which it reports must be 'substantially an original contribution to the subject concerned' (University of New England, 1994, p. 19). This section of the final chapter is intended to establish that this is credibly the case for the research described in the thesis. Initially considered are contributions of the thesis to theory development in its field. Subsequently, contributions of the thesis to methodological development are explained. Finally, contributions of the thesis to extension of empirical knowledge in the field are detailed.

This research has made substantially an original contribution to theory development in the field of smaller enterprise financial management in the following respects:

- While the topic of financial reporting for internal financial management purposes in growing small and medium-sized enterprises is not entirely novel, no previous scholarly research has been discovered internationally that approaches the topic with the scope and in the depth that characterise this study. Certainly, the principal research question stated at the outset of the thesis has not been explicitly addressed in previous scholarly investigations.
- The study has produced a broad, critical evaluation of various theoretical perspectives on growth and development in smaller enterprises; and, in particular, it has drawn together and integrated disparate views on the financial dimensions of SME growth.
- The study has resulted in a comprehensive appraisal of economic, finance and strategic management theory bearing on financial reporting undertaken for internal financial management purposes in small and medium-sized enterprises seeking to grow. An original synthesis of various theoretical perspectives on financial reporting by such concerns has been presented. This provides a conceptually sound but realistic backdrop against which to view existing and new empirical evidence on this matter.
- The study has provided a theoretically sound and empirically supported conceptual framework for subsequent confirmatory inquiry into the role of financial reporting in internal financial management of smaller enterprises that are growing. Thus, as claimed earlier in the thesis, the research advances knowledge in the area beyond what previously could be construed as credible and well-intentioned supposition.
- The study has led to a theoretically sound and empirically supported research agenda for later confirmatory research into the role of financial reporting in internal financial management of growing SMEs. In so doing, it has appropriately fulfilled its ambitions as a unique exploratory investigation in its field.

This research has made substantially an original contribution to methodological development in the field of smaller enterprise financial management in the following respects:

- The study is exemplary in its attention to detail in the proper application of exploratory methodology to research into small and medium-sized enterprises. In the main, the exploratory phase of scholarly inquiry in this field has either been inappropriately neglected, or it has been very poorly understood and executed.
- The study is assiduous in selection of appropriate statistical techniques for the description and analysis of the categorical data obtained. Broadly, this has

resulted in use of non-parametric/distribution free methods that are employed far less often than they should be in the SME research literature.

- The study's use of non-linear principal components analysis for dimensional reduction/structural escalation of data for enterprise characteristics, for financial management characteristics and for financial reporting practices is very unusual in business research, and especially so in the smaller enterprise field.
- The construct of development orientation emerging as the first component in non-linear principal components analysis of enterprise characteristics is a useful methodological innovation, providing a viable and, in many respects, superior alternative to classifying SMEs according to their stage of development in some growth model.
- The construct of financial reporting climate emerging as the first component in non-linear principal components analysis of financial management characteristics is another useful methodological innovation, providing a helpful means for capturing how conducive the circumstances of smaller enterprises are to financial reporting for internal financial management purposes.
- The index of the comprehensiveness of financial reporting practices emerging as the first component in non-linear principal components analysis of financial reporting practices is yet another useful methodological innovation, providing a convenient means for capturing the overall extent of financial reporting undertaken in small and medium-sized enterprises.
- The study's use of ordinal, polytomous logistic regression for predictive modelling of financial reporting practices, and of business growth and performance outcomes, is quite unusual in business research, especially that dealing with smaller concerns.

This research has made substantially an original contribution to empirical knowledge in the field of smaller enterprise financial management in the following respects:

- The study has clearly established the importance of enterprise size in employment terms as an explanatory variable for various financial reporting and related phenomena investigated. Furthermore, the evidence presented suggests that the distinction between small and medium-sized enterprises (as defined in the research) can be significant in the context examined.
- The study has resulted in a most comprehensive international review of prior empirical evidence bearing on financial reporting undertaken for internal financial management purposes in smaller enterprises, including those seeking to grow. The paucity of reliable evidence for a growth and/or performance benefit for such concerns from undertaking more sophisticated financial reporting is noted and commented upon.

- The study has produced valuable new empirical evidence bearing on financial reporting undertaken for internal financial management purposes in small and medium-sized manufacturing enterprises legally organised as proprietary companies. Particularly notable is the generalisability lent to the research findings by the quality of the comparatively large, stratified random sample employed which has few, if any, parallels in the related scholarly literature.
- The study has provided additional empirical insight into key influences on the comprehensiveness of financial reporting undertaken for internal financial management purposes in smaller enterprises. Most important amongst these are the development orientation within such concerns and the prevailing financial reporting climate reflecting (*inter alia*) the extent of required financial reporting to external parties.
- The study has resulted in a much more realistic perspective on the facilitating role financial reporting plays in the holistic management of growing SMEs than has hitherto been evident in the relevant literature with has tended to be inappropriately value laden, overly prescriptive and without empirical grounding. The difficulty of establishing a direct nexus been the comprehensiveness of financial reporting practices and business growth and performance outcomes has been demonstrated and rationalised.
- The study has led to useful recommendations relating to financial reporting practices which are directed to those who influence and regulate smaller enterprises that are seeking to grow. Unlike many previous attempts to provide such guidance, the advice emanating from this research is empirically grounded and is far from being supposition

Some closing remarks seem appropriate about the value of this research given the present state and tenor of scholarship concerned with small and medium-sized enterprises. First, given its modest exploratory ambitions, the findings of the research could be seen (albeit less than justly) as rather pedestrian and more or less predictable. Certainly, the research does not, in the customary sense, represent some kind of break-through in the theory or practice of smaller enterprise financial management. On this point, however, a little comfort can be taken from the words of Bygrave (1989a, p. 22) who ventures that:

> In judging research, our watchword should be excellence, not routine or revolutionary.

Second, it is important to acknowledge that disappointing or negative findings have their role to play in the advancement of knowledge. Hofer & Bygrave (1992, pp. 98-99) are quite adamant that:

> . . . negative findings make a *positive* contribution to a field. They tell us about concepts, constructs, models, and theories that have *not* proved worthy of further use. One should, therefore, seek to publish such research. We suspect there are two reasons that this has not happened more in the past. From the point of view

> of the researcher, negative findings can be published only once. Starting over on a different topic is much more difficult than extending what one has already done. Consequently, there is a tendency to seek to publish positive results no matter how weak they really are. From the point of view of journal editors, there is a *legitimate* concern about being swamped by studies with negative findings. It must be remembered that not all *negative* findings are worthy of publication – only those that are truly surprising based on prior research and theory in the field! On balance, though, more negative results should be published than are. And if they were, the use of simplistic linear models and parametric statistical analysis techniques should decline as their limitations become more widely known.

Aldrich (1992, p. 208) is of a similar mind:

> Entrepreneurship research resembles many other social sciences in the way that it systematically disdains two processes central to normal scientific endeavour: 1) attempted replication and confirmation of previous findings; and 2) publication of negative findings. Instead, we are treated to 'new' concepts and 'positive' findings, as authors try to differentiate their products from their potential competitors. Presently, we have persons calling themselves theorists who need not take seriously the stream of contradictory research findings pouring out of various research programs.

Thus, an obvious final challenge facing the present research is whether, in due course, it can overcome this apparent disregard in the smaller enterprise research community internationally for less than startling and seemingly negative findings. While admittedly conjecture at this stage, prior research and publication experience over 20 years (including service as a journal editor and on the editorial advisory boards of a number of journals) suggests that several aspects of the study will, in fact, prove eminently publishable in peer reviewed conference proceedings and research journals of international standing in the smaller enterprise field. One such publication has already been achieved (McMahon *et al.*, 1997)

8.6 Chapter Review

This final chapter of the thesis has sought to summarise the findings of the study described in it, to explain the meaning and implications of the findings, and to establish that the thesis is worthy of the award of a doctorate by research. When compared to other Australian and international research in the field, this inquiry reveals that financial reporting practices amongst the collaborating businesses are of a high standard and are very encouraging from a financial management viewpoint. On balance, the evidence is that neoclassical microeconomics more accurately anticipates the financial reporting practices of the SMEs investigated than does Austrian economics. Development orientation, extent of owner-management, technological complexity, degree of reliance upon external financial advice, and financial reporting climate are found to be the most significant influences on the comprehensiveness of financial reporting practices in these businesses.

Relationships in either direction between financial reporting practices on the one hand and business growth and performance on the other have been difficult to discover, describe and explain. The reason suggested for this is that management is a complex activity affected by a myriad of interacting internal and external factors, and must inevitably be undertaken in an holistic manner in smaller concerns. Particular practices make a contribution to the whole task without necessarily standing out as all-embracing solutions to problems generally encountered. Improved financial reporting and analysis may therefore be viewed as part of a broader competence in financial management which, taken together with other functional capabilities, is likely to lead to more effective and efficient management of smaller enterprises and significantly improve their prospects. Stevenson & Harmeling (1990, p. 11) usefully summarise the argument thus:

> Organizational life has curious asymmetries. Many things are necessary, but not sufficient in and of themselves for success.

Promotion of any financial management practice to SME owner-managers might be attempted most appropriately on this basis.

As expected at the close of an exploratory investigation, a research agenda has been presented for subsequent confirmatory inquiry focused on the role financial reporting practices appear to play in the functioning of small and medium-sized enterprises that are growing. An interview based, longitudinal study of financial reporting practices in relatively large matched samples of growth and non-growth SMEs is suggested. The study would rely on an analytical schema mainly derived from the present research. Until this has been undertaken, further scholarly inquiry into the possible impact of financial reporting practices upon business growth and performance outcomes in smaller enterprises is not proposed. Considered recommendations stemming from this research have also been presented on financial reporting practices for those who influence and regulate small and medium-sized enterprises seeking to grow. Finally, the contributions of this thesis to theory development, to methodological development and to the extension of empirical knowledge have been detailed. Together, these underpin a claim that the thesis has made substantially an original contribution to its field.