Profit or No Profit—
Does the SME Sector Really Know?

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Abstract
While the SME sector is continuously in the limelight with regard to its potential role to alleviate the unemployment problem in South Africa, questions arise whether the SME sector utilises its relatively scarce resources optimally. In order to determine whether resources are optimally utilised, the SME sector in general and each SME individually has to avail of the knowledge and accounting skills to confidently answer the fundamental question whether they are making a profit or not. In this article the literature with regard to the need for SME development in South Africa as well as the skills needed by the SME sector to function optimally, will initially be addressed. The objective of the article, namely to determine whether the ME sector in KwaZulu-Natal in particular, avail of the required accounting skills to operate profitably, will consequently be addressed in the analysis of the empirical research conducted among experts in the SME sector in KwaZulu-Natal. In the final instance the summary, recommendations, caveats and suggestions for further research will be dealt with.

Keywords: Accounting skills, disequilibrium, entrepreneurship, equilibrium, factors of production, profit, profitability, resources, SME development, SMEs, sustainability.

Introduction
South Africa has been confronted with a high unemployment rate for a long period of time. At present the narrow definition of unemployment stands at

23.1% (Labour Force Survey, 2008: v). The South African Government has identified the development of small, micro and medium-sized enterprises (SMME s) as one of the vehicles to address the unemployment problem (DTI, 1995: 2). They manifested their commitment to SMME development by acceptance of the 1995 White Paper on a National Strategy for the development and promotion of Small Business that became the Small Business Act No. of 1996 (DTI, 1996:). The Act was based on the recognition of the critical role that small, micro and medium-sized enterprises could play internationally in absorbing labour, penetrating new markets and generally expanding economies in creative and innovative ways (DTI, 1995: 2). In this regard the South African Government decided to stimulate SMME development through a large range of interventions (Ministry in Office of the President, 1994: 25).

The Small Business Act which has been reviewed since and currently known as The Integrated Strategy on the Promotion of Entrepreneurship and Small Enterprises (DTI, 2008: 4), has the following broad objectives:

- Increase supply for financial and non-financial support services
- Create demand for small enterprise products and services
- Reduce small enterprise regulatory constraints

These objectives resulted in the introduction of various interventions by government coupled with various private sector initiatives to promote SMME development in South Africa. In this regard government has acknowledged the need to improve the coordination among support agencies (DTI, 2008: 27).

In order for these interventions to be optimally implemented in the quest for sustained small business development, the ideal is that all objectives should be balanced and synchronised within the larger economy. The implication is that any barriers that could prevent success or result in unsatisfactory SMME development should be detected and addressed in the introductory stage already. One such potential barrier that is specifically going to be addressed in this article is lack of or insufficient accounting skills in the SME (small and medium-sized enterprises) sector. The rationale for the emphasis on accounting skills is that unless the SME sector is able to record and monitor their financial performance, they will not be able to

determine whether they are making a profit or loss, let alone being able to determine whether the small business development efforts have had a positive impact on their businesses or not. The choice of the SME sector instead of the SMME sector is based on practical reality as the micro-sized enterprises are often not registered or do not keep financial records at all.

Literature Review

Clarification has to be provided on the use of certain concepts and terms in this article. Entrepreneurship for the purposes of this article, and fully aware of the non-agreement on an internationally accepted definition (Nieman, Hough and Nieuwenhuizen, 2003: 9), is defined as follows: an entrepreneur is an individual that takes calculated risks (Du Plessis, 1992: 88), who finds new combinations for the other factors of production (land, capital and labour) (Schumpeter in O'Farrell, 1985: 568), is innovative (Drucker, 1985: 27; Bolton and Thompson, 2004: 16), achievement-driven (Bolton and Thompson, 2004: 21), market-orientated (Carson, Cromie, McGowan and Hill, 1995: xiii), ambitious (Barringer and Ireland, 2006: 8), confidence in their ability to succeed (Scarborough and Zimmerer, 2006: 5), wealth seeking (Burch, 1986 : 32) and regards problems as challenges rather than obstacles or threats (Dollinger, 2003: 31). The level of entrepreneurship will vary from person to person. In this regard Burch (1986: 31) illustrated how entrepreneurship varies among typical categories of careers on a continuum where a labourer is depicted in the lowest category and an inventrepreneur (inventor and innovator) in the highest category.

All levels of entrepreneurs are found in businesses of all sizes. The tendency to explain entrepreneurship in a small business context rather than a large business context can be explained by the reality that most entrepreneurs, due to limited start-up resources, use the small business as port of entry into the business world (Vosloo, 1994: 159). In this article the entrepreneur within the SME sector will be focussed upon although the uthors acknowledge that entrepreneurs can operate in a business of any size. The SME sector refers to businesses that are small (5-50 employees) and medium (51-200 employees) (Department of Trade and Industry 1995: 8).

Kirzner's Theory of Entrepreneurship will be used to provide a theoretical base in support of the case for the possession of accounting skills

as one of the critical determinants of small business success. Kirzner stated that entrepreneurs act as economic agents that identify disequilibrium in the economy by taking on an equilibrating role to rectify disequilibriums (Kirzner, 1973).

Should it be added that disequilibrium usually implies that profit opportunities exist, the profit-seeking motive adds another dimension to Kirzner's theory as entrepreneurs' reaction to these profit opportunities may result in the market returning to equilibrium, provided that the reaction has been successful. A weakness of Kirzner's theory, however, is the assumption that all entrepreneurs have similar access to information and resources and that information and resources relating to entrepreneurial opportunities are readily available to all entrepreneurs (Holcombe, 2003: 25). Both entrepreneurs and potential entrepreneurs can improve their propensity to find promising ideas if they increased access to information external to their businesses (Government can help in this regard) and internally if they are able to keep accurate financial records in order to make informed decisions on the exact status of their financial resources (ample accounting skills are necessary to meet this requirement).

While it is readily accepted that large businesses can afford to appoint qualified bookkeepers to perform the accounting duties, this luxury is not prevalent in the SME sector (DTI, 1995: 28). The result of this is that SME owners/managers often have to multi-task to perform the accounting duties together with a multitude other tasks (Baumback and Lawyer, 1979: 22-30). The situation is further aggravated if they do not avail of the required accounting skills to perform the task correctly. The objective of this article will be to conduct a needs analysis of the accounting skills of SME s in KwaZulu-Natal. This could inform policy makers and other stakeholders in SME development of the situation with regard to the existing level of knowledge of accounting skills in the SME sector and whether specific interventions are needed to address the problem or not.

Apart from Kirzner's Theory of Entrepreneurship, the Theory of the Firm which is based on the assumption that the major objective of the firm is to maximise profits (Curwen, 1983: iv and Andersen and Ross, 2005:31) also support the need to keep accurate accounting records to determine whether a profit has been realised or not. From a small business development perspective, it could be argued that government and other stakeholders in

SME development would require maximum results for their SME interventions and would consequently feel uneasy if the SME sector does not avail of the required accounting skills to record and monitor their performance accurately. In this regard Fujita (1998: 29) claimed that SME s account for more than ninety percent of all enterprises in developing countries and have become the largest contributor to the economy in many other countries as well. Inability of these SMEs to provide correct accounting records of their business activities, could result in recording errors with regard to the SME sector in particular and the economy as a whole. The negative effect on the individual hard-working SME if he/she is not able to determine whether all their efforts resulted in a profit or loss is even worse.

Barriers to SME Development

Problems that are inherent to the size of the business on a global scale as identified long ago by Baumback and Lawyer (1979: 22-30), are:

- The requirement that the business owner/manager has to multi-task due to a shortage of suitable staff
- Lack of sufficient funding and the required financial skills
- Poor market knowledge
- Recent research by Radipere and Van Scheers (2007: 85-91) confirmed that there is a relationship between success and viability of the SME sector and management skills.

In South Africa specific problems that restrict SME development as identified in the 1995 White Paper on Small Business (DTI, 1995: 11), were the following:

- An absence of entrepreneurial education that prepares young people to enter the small business sector
- Segregation increased the distance between residential areas and working areas, thereby increasing the cost and risk of doing business

- Limitations on the property ownership rights of blacks made it difficult for them to acquire assets that could serve as collateral for loan financing
- Bantu Education restricted opportunities for the acquisition of technical and professional skills needed to successfully manage small businesses
- Apartheid confined the majority of blacks to homeland areas, which lacked proper business environments.

It should be noted that although the above-mentioned problems had already been identified in 1995, and consistent attempts have been made to address them, it might still take a long period of time to overcome the negative impact of the Apartheid system on SME development. In the light of the global size related problems and the South African-specific problems mentioned above, the immediate challenge to government and other stakeholders in SME development will be to address the following barriers to development:

- Difficulty among SME owners to understand and interpret the macro economic environment (Rajaram, 2008: 11)
- Restricted access to finance aggravated by historical imbalances (SACOB, 1999: 12)
- Insufficient accounting and financial skills
- Regulatory and legal constraints (DTI, 1995: 28).

Although the importance of the other problems are acknowledged by the authors, the repetitive mention of the lack of or inefficiency of the level of accounting skills mentioned in the literature, has led to the area of accounting skills being further perused in this article.

Description of and Need for Accounting Skills

In the SME sector the accounting function is concerned with collecting, analysing and communicating financial information, whereas the financial management function focuses specifically on the financing and investing activities of the firm (Atrill and Mc Laney, 2006: 2,15). Accounting can also be viewed as the maintenance of a systematic set of financial records that can

at a later stage be used as basis for meaningful reporting (Haiden, 2006: 1). It is important to appreciate the likelihood that businesses operating in the SME sector may have different accounting needs due to their diversity in the size, ownership structure and management capabilities (Rajaram, 2008: 38). A key characteristic that distinguishes smaller companies from medium-sized enterprises is the level of formalisation in terms of management and ownership structure (Van Broembsen, 2003: 2).

In any organisation, accounting relates to the collecting, analysing and communicating of financial information. These tasks are usually performed by the preparation of financial statements. Financial statements are prepared in order to provide information that is useful to a wide range of users and comprise of:

- The income statement
- The statement of changes in equity
- The balance sheet
- The cash flow statement
- The notes to the financial statements (Snowden-Service, 2007: 8).

One of the primary functions of accounting is to measure and communicate the financial results and financial position of the business (Haiden, 2006: 1). In South Africa, the requirement of companies to prepare financial statements is stipulated by the Companies Act, which requires that all companies, regardless of their form and size, must prepare annual financial statements in terms of Generally Accepted Accounting standards, so that the needs of internal and external users are met (Stainbank and Wells, 2005: 51).

These financial statements are used by those parties who make decisions relating to the business and in maintaining control over the business. Apart from keeping a record of daily activities, owners and managers of businesses may need accounting information to:

- Develop new products and services
- Borrow money to help finance the business
- Change the operating capacity of the business

- To determine whether they are realising a profit or not (Atrill and Mc Laney, 2006: 2).

In a company context it is important to note that apart from the owners and management of a company that need information from financial statements, various other stakeholders need information as well, such as: lenders, suppliers, customers, investors, competitors, employees and their representatives, government and community representatives (Atrill and Mc Laney, 2006: 6).

Although most SME s are not registered as companies, it is important to assess the regulatory environment relating to the preparation of annual financial statements for companies, as many businesses in the SME sector may aspire to grow to the level of formalisation found in these companies (Rajaram, 2008: 41). At the moment, however, SME s who are not registered as companies, are at least exempt from the requirement of the Companies Act with regard to compliance with Generally Accepted Accounting Practice (GAAP) and International Financial Reporting Standards (IFRS).

Having motivated the need for accounting skills in the SME sector in order to monitor and optimize small business development in the Introduction, having explained the concept of entrepreneurship in a SME context and having provided the theoretical base for the possession of accounting skills, the accounting skills needed by SME s were consequently described and explained in the Literature Review. The next section will deal with the Research Methodology used to empirically determine the need for and level of accounting skills in the SME sector.

Research Methodology

Research Problem

To determine and evaluate accounting skills that are needed by the SME sector in KwaZulu-Natal and whether improving accounting skills will enhance the profitability of SME s in the province.

Research Objectives

1. To analyse the availability of accounting skills in the SME sector in KwaZulu-Natal through empirical research
2. To evaluate whether there is a need to improve the accounting skills in KwaZulu-Natal.
3. To assess expert opinion on whether an improvement in accounting skills will enhance the profitability of SME s in the province.

Nature of the Research

Qualitative research of an exploratory nature has been undertaken in order to accurately explore and describe the accounting skills needs of the SME sector in KwaZulu-Natal.

Sample Frame

The research conducted by Baumback and Lawyer, although approximately thirty years ago, appears to be supported by recent research in the SME sector in South Africa. Radipere and Van Scheers (2007: 85-91) confirm that there is a relationship between the success and viability of the SME sector and managerial skills. The research established that the lack of managerial skills in the small business sector has a negative impact on the success and viability of these businesses and that there is an urgent need to improve business skills in the sector.

An important aspect of qualitative research is to identify the purposefully selected sites or individuals for the proposed study that will best help the researcher understand the problem and the research question. This does not necessarily suggest random sampling or the selection of a large number of participants as found in quantitative research (Creswell, 2003: 185)

Given the lack of business skills highlighted above, it may be more prudent to rely on the opinion of industry experts in order to analyse the accounting skills needs of the SME sector in Kwa-Zulu Natal. Exploratory qualitative research can greatly benefit form the use of a survey of experts (Malhotra, 2004: 77). This is may be the case in the SME sector where SME owners/ managers may not have the necessary skills to determine their needs

due to the high rate of business failure, and the possibility that they may not provide confidential financial information. Industry experts on the other hand, may be more knowledgeable on the needs of the sector as a result of them having a broader and more adverse view.

Sample Size

In qualitative research the issue of sampling has little significance since the aim of this type of research is to explore or describe the diversity in a situation, a phenomenon or an issue (Kumar, 2005: 165). The emphasis will therefore be on obtaining a diverse range of expert opinion rather than selecting numerous individuals to collect information from. In this regard a sample size of thirty industry experts were considered an appropriate sample size to obtain the diverse feedback from different sets of experts for the qualitative study. The authors realise, however, that the findings cannot be generalised to the total population, as a representative sample has not been taken.

In order to ensure that the individuals selected do have the necessary knowledge to make a contribution to the research, they will need to ensure that they meet at least one of the following criteria:

- A formal business qualification relating to the SME sector
- At least five years experience with SME development
- At least five years experience in management of a SME
- Experience in the training of / Involvement with accounting in the SME sector

These experts, meeting the above criteria, will be grouped as follows:

- **Group One: Entrepreneurs**

This group comprises entrepreneurs that have experience of successfully owning a business that conforms to the definition of a SME that was agreed upon in chapter two.

- **Group Two: Accountants**

This group consists of individuals that are involved in the provision of accounting services to SMEs in the province.

- **Group Three: Academics**

This group consists of academics that have exposure to the SME sector.

- **Group Four: Other Experts**

This group comprises of financiers, other service providers, policy makers and any other experts that are involved in the SME sector.

Data Collection Method

Questionnaire-based personal interviews have been conducted in order to collect the maximum in-depth information from the identified experts and clarify possible problem areas.

Questionnaire Design

The questionnaire was based on the literature review and consisted of the following sections relevant to this article:

Section A:	Profile of the respondent
Section B:	Business problems experienced by the SME sector
Section C:	Accounting skills related questions

Data Analysis

The results of the interview will be thoroughly analysed using the SPSS (version 15) and will also be used to test the following hypothesis:

Hypothesis

The hypothesis is important to bring clarity to the research problem (Kumar, 2005: 74) and is derived from the objectives of the research. The research objective can be tested by the following hypothesis:

> H0- There is no need to improve accounting skills in the SME sector in KwaZulu Natal
> H1- There is a need to improve accounting skills in the SME sector in KwaZulu Natal

Findings

Section A: Profile of the Respondents

There was an even distribution of respondents from the different fields relevant to accounting and financial management i.e. entrepreneurs (30%), accountants (20%), financiers and other experts (26.7%) and academics (23.3%).

The different occupations were also evenly distributed with a majority of the respondents being entrepreneurs (30%), academics (23.3%) and service providers (20%).

The modal age group was the 35-44 years (40%) followed by 45+ years (36.7%). The majority of the respondents (60%) were postgraduates followed by those respondents who had a matric or below (16.7%). The modal race group was Asian (46.7%0 followed by the white race group (36.7%). There was a split in the number of years of involvement in the SME sector in KZN with 5-10 years (43.3%) and 10+ years (56.7%). The decision to adopt a qualitative approach by interviewing industry experts appears to be justified by the qualifications and experience of the respondents. The experience and qualification of these respondents in the SME sector will hopefully provide this study with the relevant information in order to analyse the accounting skills needed by the SME sector.

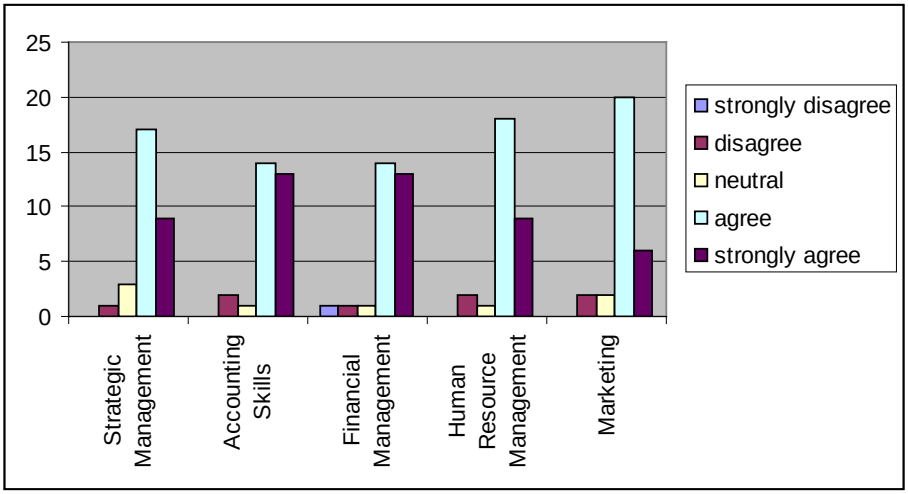
Section B: Business Problems Experienced by the SME Sector

In response to the assertion that SMEs are managed well, 16.7% of the respondents strongly disagreed, 43.3% of respondents disagreed and 23.3% remained neutral. The following summary gives the areas where respondents indicated the SME sector experience difficulties:

Figure 1: *Table and graph showing areas where SMEs experience difficulties*

	Strategic Management	Accounting Skills	Financial Management	Human Resource Management	Marketing
strongly disagree			1		

disagree	1	2	1	2	2
neutral	3	1	1	1	2
agree	17	14	14	18	20
strongly agree	9	13	13	9	6



In each of the above five alternatives there are 80%-95% of the respondents that agree and strongly agree that there are definite areas of difficulty that the SME sector experiences.

The areas that have been identified as being areas of difficulty corroborate other research. For example, some of the common business problems experienced relate to ineffective management planning, management information, poor controls, marketing and unsatisfactory financial management (Pather, 2003:10-13). Clover and Darroch (2005: 238-263) highlighted that many SMEs view a lack of management skills as a major threat to the businesses. The above findings may also support the assertion (Jinabhai and Kadwa, 2007:15-25) that mentorship and training may be used as a strategy to improve productive growth in the sector.

Approximately seventeen percent of the respondents strongly disagree and 40% disagree that SMEs have sufficient funds to operate. These findings support the view of SACOB (1999:12), Clover and Darroch

(2005:238-263) and Mutezo (2003:93), which identified a lack of sufficient funds as a major obstacle to the growth of the SME.

It is evident that a lack of accounting skills represents a major problem area for the SME sector in KwaZulu-Natal (KZN). The above findings are consistent with the previous research. For example Taylor (2003:11) presented a strong case for the SME sector to possess accounting skills as a means to improve their control over the business. It is also important to note that there may even be a link between SME business failure and a lack of accounting skills (Stone, 2003: Preface). Kotze and Smit (2008:35) have established that a lack of knowledge of financial management contributes to a low prevalence of new venture creation and ultimately the high failure rate of South African SME s.

Section C: Accounting Skills Related Questions

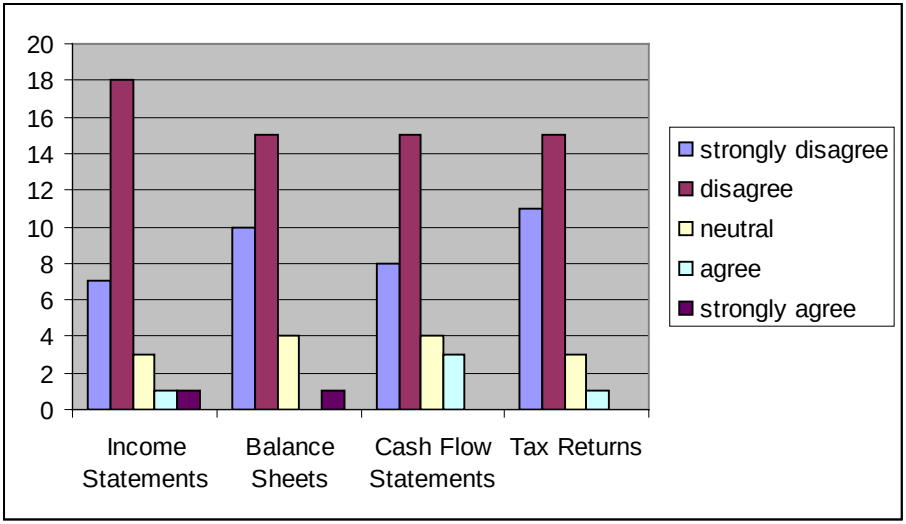
Fifty percent of the respondents strongly agree and 40% of the respondents agree that accounting skills are important to the SME sector in KZN. A modal response of agree (66.7%) was given to the question that Accounting needs of the SME sector are different from larger businesses whilst 26.7% and 60% strongly disagree and disagree to the question that there is sufficient level of accounting skills in the SME sector in KZN.

These observations highlight the importance of accounting skills in the SME sector and it does appear that these skills are largely unavailable to the sector. It is also important to note that the experts feel that the accounting needs of the SME sector are different to the larger businesses. Therefore the question: 'Is small business just a "small" big business or is it something else?' (Dewhurst, and Burns, 1983:3) has been answered by the respondents, from an accounting skills perspective, by agreeing that a different set of accounting skills are needed by the SME sector.

The diversity in the accounting needs of the SME sector from larger businesses clearly highlighted the needs for a different set of accounting standards for the sector. For example the President of the International Federation of Accountants argued for a separate set of accounting standards for the SME sector (International Accounting Standards Board, 2006:2). In South Africa, the literature review also indicated that the idea of a separate set of accounting standards for the SME sector enjoyed considerable support

(Stainbank and Wells, 2005:51-65). Although the respondents agree that accounting skills are important, there is consensus that these skills are unavailable. This finding should be of concern to the provincial government as it may be an indication that much of the business training that is being provided, is not producing the desired results. Examples of the business training are those provided in terms of the Integrated Small Business Strategy (DTI, 2005:5-6), the SMME Support Service Delivery Network (Mkhize, 2006:1-7) and Seda (www.seda.org.za).

Figure 2: *Graph of Management/Owner's lack the necessary skills to provide the following essential accounting functions*



The information obtained from this section has serious implications for the SME sector, considering the importance of accounting skills for the continued growth and profitability of the sector. Although a basic level of accounting skills are needed to prepare an income statement, balance sheet, cash flow statement and income tax returns (Taylor, 2003:13), such tools will assist the sector in undertaking important business decisions, determining the financial position and understanding and reducing tax liabilities. It is evident that the relevant authorities should consider the mechanism to impart these basic skills to the sector.

Given the importance of the financial statements to measure and communicate the financial position and results of the entity (Haiden, 2006:1), and of tax skills and knowledge in the long-term survival of the SME (Venter and De Clecq, 2007:72-78) absence of these skills will have a negative effect on the performance of the sector. It is vital that these accounting skills are considered when policy makers consider the training needs of SMEs.

Hypothesis

The hypothesis that was developed related to the need to improve accounting skills in the SME sector in KwaZulu -Natal and was formulated as follows:

- H0: *There is no need to improve accounting skills in the SME sector in KwaZulu-Natal*
- H1: *There is a need to improve accounting skills in the SME sector in KwaZulu -Natal*

In order to test this hypothesis, the Chi-Square Goodness of Fit test was used to hypothesize what responses should be based on the null hypothesis and test this against the actual responses. At the 5% significance level, since the p-values are all less than 0.05, the H0 is rejected resulting in a conclusion that there is a need to improve accounting skills in the SME sector in KwaZulu-Natal.

Need to Improve Accounting Skills and Impact on Profitability

An overwhelming 53.3% and 43.3% agree and strongly agree that the improvement of accounting skills can enhance the profitability of the SME sector in KZN. This point is further solidified with a dominant response of agree (56.7%) and strongly agree (43.3%) feeling that the SME sector in KZN will benefit from accounting training. There was obvious consensus with regard to this response since the total percentage of this affirmation (agree (43.3%)+strongly agree (56.7%)) adds up to 100%. A combined total response of 90%, made up of agree (40%) and strongly agree (50%) felt that

there is a need for an improvement in accounting skills in the SME sector in KZN.

Finally, 56.7% and 33.3% of the respondents agree and strongly agree that a lack of accounting skills can result in a shortage of funds in the SME sector in KZN. This is an important observation as it answers a question relating to the research conducted by Mutezo (1993), who confirmed that although a lack of access to funds is the largest obstacle faced by the SME sector, further research should be conducted into 'certain skills that are a prerequisite for a successful application for finance such as bookkeeping, cash flow management and drafting of business plans' (Mutezo, 2003:93). These observations seem to confirm that a lack of accounting skills is a contributory factor to the shortage of cash.

Considering the low entrepreneurial success rate in the country (UCT, 2005:21) (Centre for Development and Enterprise, 2004:5), it may be feasible to assume that an improvement in the accounting skills of the SME sector will have the potential to contribute to the growth and profitability of the sector.

Summary, Recommendations, Caveats and Suggestions for Further Research

The need for SMEs to function optimally in order to reach their full potential with regard to profitability, growth and sustainability was dealt with in the literature review. It was further emphasized that government and other stakeholders in SME development also need to be convinced that the SME sector avail of the required accounting skills to be able to determine whether they are making a profit or a loss. Insufficient accounting skills in the SME sector have been identified as one of the reasons for failure in the literature review. The majority of experts interviewed in the empirical study confirmed that insufficient accounting skills in the SME sector is a major problem and that it will effect negatively on profit levels in the sector. It is therefore recommended that government and other stakeholders in SME development should address the improvement of accounting skills in the SME sector as a matter of urgency. Some caveats of this research was the fact that only experts were used in the empirical study and that a representative sample of the entire SME sector was nor taken. A further caveat was that the study was confined to experts in KwaZulu-Natal only and not extended to the other

provinces. Further research could extend the study to all SME s, other provinces and investigate the potential of existing training initiatives to successfully address the insufficient accounting skills in the SME sector.

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Profit or No Profit—Does the SME Sector Really Know?

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