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Impact of Accounting Practices in Institutional Borrowing of SME Organizations: A Bangladesh Perspective

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Abstract:

This study has been initiated to examine the relationship between properly maintaining books of accounts of SME organizations and institutional lending by banks. To conduct this study, both secondary and primary data has been used. A formal structural questionnaire has been designed for collecting data from the respondents. Some financial tools, techniques and descriptive statistics have been applied to analyze the data. The study found that there is a significant relationship between record keeping and granting credits by the schedule banks in Bangladesh. It is also found that banks highly depend on collateral and financial strength of the SME organizations before granting loan.

Key words: *SME, Record Keeping, Books of Accounts, Loan, Accounting Practices.*

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I. Introduction

Small and medium-sized enterprises (SMEs) are the backbone of the national economy in Bangladesh (Alauddin & Mustafa 2015). Despite limited data, micro, small and medium enterprises (MSMEs) are undoubtedly the backbone of non-farm job creation in Bangladesh. About 99 percent of all non-farm enterprises fall within the micro and small enterprise categories, providing employment to 20.3 million Bangladeshi workers in 2013 (World bank report 2019). The contribution of SME in economic growth is marvelous throughout the last decade. The lion part of the domestic production and income generation are facilitated by this sector. SMEs play dominantly important role in the national economy of Bangladesh by making up over 90 percent

of industrial enterprises, providing employment to 4 out of 5 industrial workers and contributing to over one-third of industrial value-added to gross domestic product (GDP). The relative SME share in manufacturing value-added is much higher and estimated to vary between 45 to 50 per cent of totaling value-added generated by the manufacturing industries sector. Rapid and sustainable growth of SMEs is undoubtedly one vehicle for accelerating national economic growth to the point of having a measurable impact in the way of reduction of poverty and unemployment, generation of more employment. More than 90% of the industrial enterprises in Bangladesh are in the SME size-class (Alom 2006). Although the sector has great contribution in economy; however, the sector faces different constraints including easy access to finance. The business basically run through own finance paid by the owner and get some sort of informal finance from different individual and agency. Formal loan in the form of institutional loan is still out of their touch. SMEs are considered as a vital instrument for new employment generation, poverty alleviation and rapid industrialization (Ahmed, 2009). These enterprises are considered as engines of economic growth and the prime mover of any economy around the world. All countries are trying hard to develop entrepreneurs, promote SMEs and facilitating their graduation into large industries for rapid industrialization (Abdin 2015). SMEs accelerate the

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entrepreneurial skills which help the entrepreneurs to adjust the business with changing market conditions by diversifying economic activities (Zaman & Jahirul 2011).

Government previously attempted to provide small and medium enterprises with access to finance through targeted lending. There was a government directive that 5 per cent of bank loan portfolio be set-aside for small and medium enterprise financing. A separate bank, namely, the Bank for Small Industries and Commerce (BASIC) was set up in 1988 with the objective of financing the small and medium enterprises. There were also some attempts to channelize to the sector through public and private banks fund received from international agencies. There were provisions of favorable debt equity ratio, special interest rates and credit guarantee scheme. The central bank also issued directives to both public and private commercial banks regarding working capital loans, use of standardized documentation procedure and time limits for credit sanctioning and loan disbursement. Notwithstanding all these arrangements for financing small and medium enterprises, the actual delivery of institutional credit to this sector has been grossly inadequate and the rate of interest has been sharply increased with the passing of days. One of the main factors that have hampered flow of institutional finance into small and medium enterprises is a bank preoccupation with collateral based lending. Traditionally banks have used fixed asset ownership particularly land ownership as the basis for judging credit-worthiness. This puts small and medium enterprises at relative disadvantage as they often cannot put up such collateral for loan. Moreover, whatever collateral they can manage in taking the term loan leaving them with no means to seek working capital loan from institutional sources. However, the SMEs of Bangladesh are facing many problems. Along with other problems, financing is the major problem faced by most of the SMEs in Bangladesh (Taslim 2014). If the financing problems had been solved, the SMEs could have contributed more to the economy. Venture capital, bank syndication scheme, HRD in financial institutions and in government offices, training and development etc. as potential tools of eliminating the constrains of SMEs financing (Chowdhury, Azam, & Islam, 2013).

Therefore, this study wants to explore whether the bank provide any documentation barrier in the form of maintaining proper books of accounts or not.

II. Literature Reviews

A significant number of works have been conducted on SME business and it's financing in the world as well as in Bangladesh. Out of them, the following studies are being outlined here for the understanding the level and position of SME business and their financing barriers.

Ahmed (1999) specified that lack of national quality policy, adequate support system, and lack of credibility of the quality certification authority, SMEs of Bangladesh are the prime causes failed to ensure the quality of products and services both in domestic and international markets. His study also mentioned that access to finance possess as one of the most important problems for the SMEs in Bangladesh. Lack of investment or operating funds remains as one of the most prominent complains of the SMEs in Bangladesh.

Raihan (2001) found that about 50.53 % of SMEs out of access to Institutional sources of finance. Only 35.79 % of SMEs have unrestricted access to the formal credit. The remaining 13.68% of them have restricted access to the formal credit. The SMEs around 59.6% mostly seek finance for their working capital.

Alam Md. Shamsul & Ullah Md. Anwar (2006) studied on "SMEs in Bangladesh and Their Financing: An Analysis and Some Recommendations" and explored the SMEs are accounting for 25 percent of GDP, 80 percent of industrial jobs, and 25 percent of the total labor force in Bangladesh even though the prospective sector gets negligible facilitation from different support service providers. There are various constraints that hinder the development of SMEs in Bangladesh, such as lack of medium to long-term credit, limited access to market opportunities, technology, and expertise and business information. Lack of suitable incentives, inefficient and limited services from relevant government agencies as well as poor capacity of entrepreneurs are other reasons for the slow growth of SMEs. They also recommended that the government has many things to do to flourish the SMEs because, if they flourish, SMEs will create new entrepreneurs, generate more jobs and contribute to a great extent to the national economy.

Huang et, al (2014) researched on "Analysis on Financing Difficulties for SMEs due to Asymmetric Information" and found that financing is the bottleneck that restricting the development of China's small and medium enterprises. The root cause of financing difficulty for SMEs is the serious information asymmetry that exists between financial institutions, which lead to adverse selection and moral hazard. They used dissymmetry and credit rationing theories to analyze the financing difficulties for SMEs and financing strategies to crack financing difficulty.

Bosri. R (2016) conducted a study on "SME Financing Practices in Bangladesh: Scenario and Challenges Evaluation". The study aims to evaluate the importance of SME in Bangladesh and which sectors get SME financing, who are the major facilitator of SME financing in Bangladesh. The findings of the study suggests that the success rate of SME financing is very high as well as it contributes to the GDP significantly in Bangladesh but disbursement of SME loan is low than industrial loan.

Haron et. al (2013) investigated “Factors Influencing Small Medium Enterprises (SMES) in Obtaining Loan”. The objective of the study is to examine as to whether the character (or management’s knowledge of business) of having collateral and also the capacity of borrowing by the SMEs, which is measured by default in loan shown by CCRIS report (Central Credit Reference Information System), will have an influence on the loan approved by the bank officers. The Findings showed that all the three variables had significant effect on the likelihood of the loan approval by the financial institutions from the perspective of credit officers. SMEs should be better prepared when applying for loan with getting the collateral, good relationship with financial institution and having a good financial record. On the other hand government agencies assisting SMEs should educate them to ensure that they are equipped with the knowledge to prepare the required documentations required by the financial institutions.

Rahman, Elahi, Gupta et. al (2014) looked into the “Assessment of Accounting Software practices in Small Medium Enterprises (SMEs) of Bangladesh: A Survey of Barrier and Adoption (Dhaka City)”. The aim of this study is to show that how the factors of barrier affect practicing of Accounting Software in SMEs of Bangladesh. The result of this study suggests the proper application and use of Accounting Software ensures strong responsibility and accountability of the business enterprise and it also helps the owner and policy makers of the firm’s to better understanding about their performance and result and with employing accounting software technology, small and medium business enterprises can reduce its operating cost and then increasing its profitability and competitive power.

Ntim, Evans and Anthony (2014) conducted a study on “Accounting practices and control systems of small and medium size entities: A case study of Techiman municipality”. The study revealed that SMEs kept at least one book of account to record business transactions. The results obtained on the control system of SMEs revealed that SMEs set up various accounting controls in their operations. The results also revealed that, the need to prepare a complete set of financial statements is determined by the size of the firm, age of business and engagement of accounting personnel. It is recommended that national regulators must develop specific accounting guidelines for SMEs and develop accounting training programs for entrepreneurs in small businesses.

Chakraborty Ashok (2015), studied on “Impact of Poor Accounting Practices on the Growth and Sustainability of SMEs”. The main purpose of this study is to focus how poor accounting practices hamper the growth and sustainability of SMEs, how different stakeholders are affected due to the lack of quality accounting information. SMEs act as backbone of the business and commerce creating many entrepreneurs, involving different stakeholder, creating job opportunities for skilled and half skilled workforce, playing role like lubricant for the local economy. Due to the lack of public accountability, regulations, audit requirement and some other reasons many SMEs do not have systematic accounting practices which incorporate a huge negative impact on the growth and sustainability of SMEs. Due to the lack of quality accounting information many owners/managers of SMEs are found to take inaccurate and clumsy decisions regarding investment, credit, operations etc. Such inaccurate and faulty business and strategic decisions results excess costs of capital, investments in the low return even in the loss project, inefficient business operations etc.

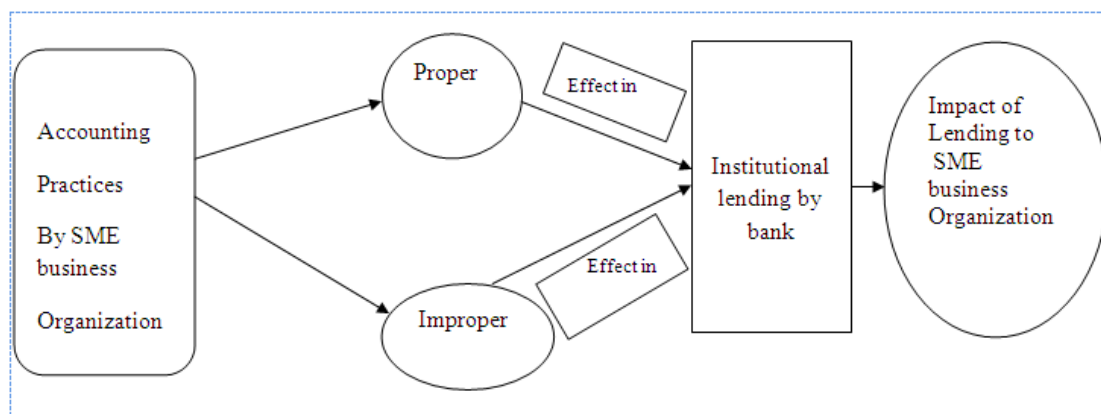
III. Objectives and Methodology of the Study

This study has been initiated to find out the answer of some of the inquisitive questions which has been shaped by some objectives. The main objective is primarily to find out whether is there any impact of proper accounting practices of SME sector of Bangladesh in obtaining institutional borrowing. Besides, to look into what are the additional factors are preferably considered by financial institution specially bank in granting credits. To conduct this study, primary sources of information from the respondents have been used. A formal structural questionnaire has been used for collecting data from the respondents. The respondents have been categorized into two types i.e. commercial banks having SME loan product and the different SME type of business. About 120 SME business organization have been selected randomly.

IV. Research hypothesis and Theoretical Model

H0: There is no relationship between SME institutional borrowings and proper accounting practices.

H0: There is no other preferable factor except collateral to bank in granting SME credit



V. Analysis and Interpretations

The following data have been analyzed with the statistical software SPSS:

5.1 SME organization keeps regular records of transactions:

Does SME organization keep regular records of transactions?

	Frequency	Percent	Valid Percent	Cumulative Percent
Valid Yes	116	97.2	97.2	97.2
No	3.6	2.8	2.8	100.0
Total	120	100.0	100.0	

About 97.2% SME organizations of Bangladesh keep regular records of business transactions either partially and completely. It is also observed that 33.33% SME organization maintain proper books of accounts where 66.7% maintains partial rerecords of transactions. Besides, the study found that 50% of the organization keep permanent accountants for looking after the business transactions. Approximately 95.5% organizations keep vouchers of their transaction incurred over the accounting period.

5.2 Use of accounting software:

Does SME organization use software?

	f	%	Valid %	Cumulative %
Valid Yes	24	19.4	19.4	19.4
No	96	80.6	80.6	100.0
Total	120	100.0	100.0	

This study explored that about 19.4% of the SME organization in Bangladesh uses software for recording business transactions and maintaining books of accounts.

5.3 Record keeping system in SME sector:

Considering accounts maintaining system of SME organization is not systematic enough in Bangladesh. Usually, SMEs maintain partial accounting systems and about 58.3% organization does not maintain income statement. Besides, 69.4% organizations of the SMEs do not keep Balance Sheet to show financial position of the concern. Moreover, only 19.4% organizations keep owner's equity statements to demonstrate owner's claim to the business. Voucher keeping system and internal checking process are quite good enough of SME organization in Bangladesh as about 94% organization keeps proper vouchers where 61% organization maintain internal checking system of their transactions. However, a very insignificant number of organization (13.9%) has a policy of internal auditing books of accounts to find out error and fraudulence manipulations of books of accounts. About 83% of the organization has been rejected to take SME loan from different financial institutions like Bank and leasing companies. It is also seen that 100% of the financial institutions asked to submit different books of accounts to sanction the SME loan.

Table: Record keeping in SME sector in percent

Maintaining proper books of accounts		Partial record keeping		Keeping income statement		Keeping balance sheet		Keeping owners' equity		Keeping vouchers		Internal checking system	
Yes	41	Yes	94	Yes	41.3	Yes	30.6	Yes	80.6	Yes	94	Yes	61
No	59	No	06	No	58.3	No	69.4	No	19.4	No	06	No	39
Total	100	Total	100	Total	100	Total	100	Total	100	Total	100	Total	100

Source: Authors calculation from the data of field survey

5.4 Data on financing problem in SME sector:

In spite of taking various policies by Bangladesh Bank and other institutions to increase the availability of SMEs to credit but still the SME sector is struggling to access the facilities. The following table shows that around 83 percent SMEs has limited accessibility to finance which is the prime constraints faced by organization. Out of the studied organizations, around 85 percent wished to take financial support from the institutional sources but did not find support in the form of loan. Besides, 91 percent of the study SMEs failed to utilization of full capacity due to the financing problem. The study also revealed that collateral demanded by the institutional lenders is the most significant constraints rather than formal record keeping to access loan.

Table: Financing problems in SME sector

Desire to take loan from institutional source/s		Institutional accessibility		Collateral requirement creating barrier to get loan		Suffering from financing problems	
Yes	83%	Yes	83%	Yes	83%	Yes	83%
No	17%	No	17%	No	17%	No	17%
Total	100%	Total	100%	Total	100%	Total	100%

Source: Authors calculation from the data of field survey

5.5 Regression Analysis

Linear regression is the next step up after correlation. It is used when we want to predict the value of a variable based on the value of another variable. The variable we want to predict is called the dependent variable (or sometimes, the outcome variable). The variable we are using to predict the other variable's value is called the independent variable (or sometimes, the predictor variable). This study has taken rejection of SME loan granting as dependent variable where different factors like record keeping, types of record keeping, use of software have been used as independent variable.

Model summary

Model	R	R square	Adjusted R square	Std. error of the estimate
1	.722 ^a	.521	.301	.31603

The R value represents the simple correlation which is 0.722 that indicated high degree of positive correlation. The R² value (the "R Square" column) indicates how much of the total variation in the dependent variable, rejection of loan, can be explained by the independent variable, record keeping of SME organization. In this case 52.1% can be explained, which is satisfactory.

ANOVA

Model		Sum of Squares	d.f	Mean Square	F	Sig.
1	Regression	2.603	11	.237	2.369	.037 ^a
	Residual	2.397	24	.100		
	Total	5.000	35			

From the regression model forecasts the dependent variable significantly well. The "Regression" row and the "Sig." column indicate the statistical significance of the regression model that was run. Here, $p < 0.037$, which is less than 0.05, and indicates that, overall, the regression model statistically significantly predicts the outcome variable (i.e., it is a good fit for the data). There our null hypothesis is rejected and it can be said that there is significant association of record keeping and granting institutional lending by the financial organizations. Besides, record keeping banks also look for collateral as well as financial strength of the SME organizations.

VI. Findings

After a rigorous analysis of different data of SME organization through SPSS software, our study explored the following significant findings;

- Accounts maintaining system of SME organization is not systematic enough. They usually maintain partial accounting systems. About 58.3% organization does not maintain income statement and 69.4% organizations do not keep balance sheet to maintain financial position of the concern. Only 19.4% organizations keep owner's equity statements to show owner's claim to the business.
- Voucher keeping system and internal checking process are quite good enough of SME organization in Bangladesh as 94% organization keeps proper vouchers where 61% organization maintain internal checking system of their transactions. However, a very insignificant number of organizations (13.9%) have a policy of internal auditing books of accounts to find out error and fraudulence manipulations of books of accounts.
- About 83% of the organization has been rejected to take SME loan from different financial institutions like bank and leasing companies.
- 100% of the financial institutions asked to submit different books of accounts to sanction the SME loan
- Banks generally asked to submits different books of accounts in the form of daily sales books, cash books, estimated income statements, balance sheet and bank statement of previous month's transactions.
- SME organizations usually keep daily sales book, cash payment book, cash receipt books, and purchase book and dues book to keep record their transactions.
- This study explores that SME organizations do not usually rejected due to proper record keeping and here partial record keeping is good enough to accept their loan proposal.

VII. Conclusion

SME organizations are very important part of our economy and playing great role in economic growth and development of Bangladesh. With small financial strength and operating capacity, these organizations are working and contributing greatly in national economy. However, the accounting record maintaining status, keeping of regular accountant, maintaining of different financial statements of SME organizations in Bangladesh are not up to the mark. As most of the organizations depends on credit facility from the different institutions for their financing sources but institutions require fulfillment of some certain formalities to grant credit facilities. Banks and other financial institutions prefers to provides facility to the organizations those have collateral but now a days, banks also prefer to finance or lending money based on the status of financial performance and position of the organization through financial statements and other records and documentations. Therefore, it now becomes a matter of great important for the organizations to maintain proper accounting records for getting financial assistance from the financial institution. Besides, if SME organizations keep the proper accounting record, the actual GDP status of the country can be properly measured. This study is a simple endeavor to assess the relationship between accounts maintaining and lending money by the banks. Finally, it is expected that the SME organizations would be more conscious considering the importance of records keeping and maintaining proper books of accounts. This study has been conducted based on business organizations located on Dhaka city corporation area. The search gap of this study, it could be covered more other cities and number of responded could be more for further study.

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