



THE USE OF FINANCIAL INFORMATION IN FINANCIAL DECISIONS OF SMEs IN THAILAND

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1.1 Background of the Research

Small and medium enterprises (SMEs) in Thailand are defined as firms with 15 to 200 employees and 30 to 200 million Baht in fixed assets (depending on the business sector). SMEs play an important role in a nation's economy. They make substantial contributions to employment and comprise the majority of businesses in the nation (Burns & Dewhurst 1996; Bushong 1995; Holmes et al. 2003). In developing countries, small-scale businesses are the most important source of new employment opportunities. Governments throughout the world attempt to promote economic progress by focusing on small-scale enterprises (Harper & Soon 1979).

Thailand, classified as a developing country, has traditionally been a major rice exporter. The rice and tourism industries are important to Thailand's foreign currency earnings. From the mid-1980s until 1997, Thailand experienced a booming economy and double-digit growth. But in June of 1997 the Thai government experienced an abrupt slowdown to less than 2 percent growth. Both small and large firms suffered from this economic crisis. To revive and develop the country's economy and because they are an important element in economic development, the government realized that SMEs have to be supported by them (Institute for Small and Medium Enterprises Development; Industrial Estate Authority of Thailand). SMEs generate employment, add value, bring in foreign currency and investment, improve labour skills, and have linkages with large enterprises.

SMEs in Thailand are classified into three major categories, as follows (Institute for Small and Medium Enterprises Development):

1. Production sector (including Agricultural Processing, Manufacturing and Mining).
2. Service sector
3. Trading sector (including both Wholesale and Retail).



SMEs are defined by fixed assets and size of employment as follows (Institute for Small and Medium Enterprises Development):

By fixed assets:

	Medium Enterprise	Small Enterprise
Production and Service Sectors	not exceeding Baht 200 million (not exceeding A\$ 7.4 million)	not exceeding Baht 50 million (not exceeding A\$ 1.85 million)
Trading Sector:		
Wholesale	not exceeding Baht 100 million (not exceeding A\$ 3.7 million)	not exceeding Baht 50 million (not exceeding A\$ 1.85 million)
Retail	not exceeding Baht 60 million (not exceeding A\$ 2.22 million)	not exceeding Baht 30 million (not exceeding A\$ 1.11 million)

By size of employment:

	Medium Enterprise	Small Enterprise
Production and Service Sectors	not exceeding 200 persons	not exceeding 50 persons
Trading Sector:		
Wholesale	not exceeding 50 persons	not exceeding 25 persons
Retail	not exceeding 30 persons	not exceeding 15 persons

A report of the Bangkok Bank shows that in 1998 there were 311,518 SMEs in Thailand, 92% of all enterprises in Thailand, comprising of 131,171 (43%) SMEs in the trading sector, 90,122 (28.9%) SMEs in the production sector, and 87,225 (28.7%) SMEs in the service sector (Institute for Small and Medium Enterprises Development).

Although SMEs represent a majority of Thailand's national economy in terms of output, employment and effective utilization of regional resources, they are characterised by poor management and/or administrative skills, limited marketing



skills, minimal technology skills, and a lack of access to government and institutional credit facilities (Institute for Small and Medium Enterprises Development).

SMEs lack of access to capital and high interest rates charges are partially the result of incomplete (or no) accounting records, and the inefficient use of accounting information. Poor record keeping and accounting information make it difficult for financial institutions to evaluate potential risks and returns (World Bank 1978), making them unwilling to lend to SMEs. As a result, SMEs pay high interest rates or fall back on the middlemen or moneylenders, whose loans are costly and often restrictive (Institute for Small and Medium Enterprises Development). The misuse and inaccuracy of accounting information causes SMEs to inaccurately assess their financial situation, and make poor financial decisions, as well as leads them to face with the high failure rate (Byron & Friedlob 1984; DiPietro & Sawhney 1977; Fredland & Morris 1976).

Due to the lack of access to the capital markets, the allocation of capital in small firms is very important. Capital assets involve a large amount of money. It should be planned to be sure funds are available. The result of capital budgeting decisions continues for many years. Unnecessarily high expense (depreciation and others) will occur, if the firm invests too much. In contrast, uncompetitive production and lost of market share due to insufficient model and inadequate capacity of equipment may arise, if the firm does not invest enough. An incorrect forecast of asset requirements can have serious consequences. Effective capital budgeting can improve asset acquisitions (Brigham, Gapenski & Ehrhardt 1999). Although capital budget is important to small firms, they do not use the tools that have been developed to improve these decisions (Runyon 1983). Studies show that many small firms are more likely to rely on the payback approach, even though the NPV and IRR methods are both superior to the payback (Graham & Harvey 1999 quoted in Brigham & Houston 2001; Walker, Burns & Denson 1993). Runyon (1983) showed that a small business may put itself at a serious competitive because it fails to use sophisticated discounted cash flow methods.



Even though SMEs are the base of the country's economy, little research has been done on them. Previous studies on Thailand's companies emphasized publicly listed firms. For instance, Yammeeesri (2003) examined the effects of ownership structure on the corporate performance of Thai non-financial listed firms between 1993-1996. Graham, King and Bailes (2000) investigated the relationship between Thai accounting information and Thai security prices, before and after the chaotic devaluation of the baht in 1997. Tirapat and Nittayagasetwat (1999) investigated Thai listed firms' financial distress using macro and micro variables. Also Person (1999) examined a number of quantitative and qualitative variables in predicting bankruptcy for finance companies in Thailand.

This paper will study the use of financial information in financial decisions of SMEs in Thailand's trading sector only, as SMEs are mainly in the trading sector, and some financial controls and techniques may apply differently in other industry sectors. In this study the decision to raise external funds and to invest in long-term assets will be referred to as the "financial decisions".

1.2 Problem Identification

Even though SMEs play an increasingly important role in providing new products and employment opportunities, SMEs in Thailand have encountered many difficulties, especially financing. SMEs frequently lack access to institutional credit (World Bank 1978), causing them to encounter high financing costs and high failure rates (Byron & Friedlob 1984; DiPietro & Sawhney 1977; Fredland & Morris 1976).

The possible reasons for SME failures include 1) a lack of demand for their product or service, 2) the poor management and/or administrative skills of the owner/manager, 3) a lack of experience in the particular industry, 4) insufficient capital invested by the owner, 5) an over-reliance on external borrowings, 6) poor record-keeping, and etc. (Brooks, Collings & Gonzales 1990). Poor record keeping and inefficient use of accounting information are a major cause of the above



according to Berryman 1982 (Berryman 1982 quoted in Siop 1997), Walton 2000, Wichmann 1983, World Bank 1978. The inefficient use of the accounting information to support their financial decision-making (Ubonratchathanee University 2000) and the low quality and reliability of financial data (Kingkaew & Limpaphayom 2001) are part of the main problems of SMEs in Thailand.

Accounting information signals that decisions are needed, and provide information useful to making decisions (Gibson 1963 quoted in Thomas & Evanson 1987; Report of the study group on the objectives of financial statements, American Institute of Certified Public Accountants, 1972 quoted in Lothian 1976). Accounting information is used to assess the profitability of alternative courses of action, measure performance, and evaluate the position of enterprises in term of profitability, liquidity, activity and leverage. It can be used to improve SME performance, especially financial decisions. Different capital structures cause different degrees of financial risk. Different alternative financial plans affect SMEs' performance differently. Thus, proper accounting is a key to small business success (Wichmann 1983).

The literature suggests that after complying with statutory requirements there is no other use of financial statements by most SME owners/managers. The accounting regulatory framework is considered by most SMEs as something of a haphazard patchwork (Walton 2000). Although, most of small businesses prepare financial reports for statutory purpose, many fail to use these reports (DeThomas & Fredenberger 1985). SMEs owners/managers either lack the technique for using financial statements (Byron & Friedlob 1984; DeThomas & Fredenberger 1985) or simply are unaware that they can use them to support the financial decisions. Poorly prepare accounting information render most SMEs unable to evaluate their own financial situation, or to demonstrate viability, and or to facilitate loan financing. This situation causes improper financial decisions and ends up with low performance and high failure rate.



The use of efficient capital budgeting decision methods makes the task of successful operation of SMEs easier. Capital budget is very important to small firms in making long-term investments, yet many of them use “back-of-the-envelope” analysis instead of the tools that have been developed to improve their capital allocation (Runyon 1983). Consistent with the studies of Bierman 1993, Runyon 1983, and Walker, Burns and Denson 1993 found that unlike large firms, small firms do not use sophisticated capital budgeting methods. They are more likely to rely on the payback approach, capital budgeting technique that ignores cash flows that are paid or received after the payback period, while large firms are more likely to rely on net present value (NPV), as regard as the best single measure, and/or internal rate of return (IRR), a profitability measurement providing “safety margin” information. The different measures provide different types of information to decision makers. The more likelihood that discounted cash flow techniques would be used, the more survival rate increases (Brigham, Gapenski & Ehrhardt 1999).

As previously mention, SMEs are a significant component of Thailand’s economy and there is a lack of empirical evidence concerning the use of accounting information in raising external funds and making long-term investments of SMEs in Thailand. Therefore, this study will examine SMEs in Thailand to provide empirical evidence of this gap.

1.3 Objectives of the Research

The objective of this study is to construct an empirical study of the use of financial information in the financial decisions of SMEs in Thailand’s trading sector only.

1.4 Research Question

Do SMEs in Thailand’s trading sector use financial information for their financial decisions?



1.5 Research Hypotheses

The main research hypothesis in this study is:

SMEs in Thailand's trading sector do not use financial information for their financial decisions.

The main research hypothesis is divided into two sub-hypotheses:

1. SMEs in Thailand's trading sector do not use financial information in raising external funds.
2. SMEs in Thailand's trading sector do not use financial information in making long-term investments.

1.6 Definitions

Financial Information

Financial information in this study means accounting information and capital budgeting techniques.

Accounting information is information provided by accountants and accounting systems. This information is usually presented in financial statements such as the income statement and the balance sheet. It also includes any financial ratios extracted from these financial statements.

Capital budgeting techniques are the techniques used to rank assets and to decide whether they should be accepted for inclusion in the capital assets budget.

The Small and Medium Enterprises (SMEs) in Thailand's Trading Sector:



The focus of this study is SMEs in Thailand's trading sector, which consists of wholesale and retail, defined by the Ministry of Industry as follows:

Wholesale:

Enterprises	By size of employment	By fixed assets
Small	not exceeding 25 persons	not exceeding Baht 50 million (not exceeding A\$ 1.85 million)
Medium	not exceeding 50 persons	not exceeding Baht 100 million (not exceeding A\$ 3.7 million)

Retail:

Enterprises	By size of employment	By fixed assets
Small	not exceeding 15 persons	not exceeding Baht 30 million (not exceeding A\$ 1.11 million)
Medium	not exceeding 30 persons	not exceeding Baht 60 million (not exceeding A\$ 2.22 million)

The terms small enterprise, small business and small firm are used interchangeable in this study.

Financial decisions:

In this study, financial decisions means raising external funds and making long-term investments.

Owner/Manager:

In this study, owner/manager is a person who controls and makes the financial decisions for the enterprise.

1.7 Scope and Research Methodology



1.7.1 Sampling Design

Determining the population of SMEs owners/managers in Thailand is imprecise. A total of 19,798 (Institute for Small and Medium Enterprises Development retrieved 16 May 2003) SMEs owners/managers in the trading sector is listed in the Thailand SMEs website (<http://www.ismed.or.th/alliances/index.php?page=27>) and that will be used as the total population of this study. The sampling population of SMEs owners/managers is difficult to determine by location. Therefore, a systematic sample of 3,959 enterprises is created by selecting every fifth enterprise.

1.7.2 Data Collection

A survey mailing will be conducted in order to collect primary data from the sample for this study (3,959 SMEs from the trading sector, as listed in the Thailand SMEs website). The mail technique is a low cost method and permits data to be collected from a representative sample across many geographic regions where small enterprises have activities (Cooper & Donald 2001). It encourages respondents to confidentially disclose private and sensitive information (Nuckols 1964). Moreover, the study by McDonagh and Rosenblum (1965) reported that data collected by the mail questionnaire technique can be considered representative of the universe selected, in spite of only partial returns from the selected sample. It is handicapped by generally low response rates, and the response, and non-response bias (Cooper & Donald. 2001; Bryman 2001). Therefore, the survey questionnaire applied the following concurrent techniques to diminish the above disadvantages.

1. The questionnaire will be pretested by respondent surrogates in order to increase the response rate (Sletto 1940).



2. A small group of managers will be interviewed to provide more understanding of questionnaire responses and to validate conclusions (Cuba and Milbourne 1982).
3. After sending the original questionnaire up to three follow-ups will occur since that is recommended as being the most effective way of increasing response rates (Cooper & Schindler 2001; Goldstone & Kroll 1957). These three follow-ups will follow the Total Design Method (Cooper & Schindler 2001):
 1. **One week later** - A pre-printed postcard is sent to all recipients thanking them for returns and reminding others to complete and mail the questionnaire.
 2. **Three weeks after the original mailing** – A new questionnaire (Goldstone & Kroll 1957) is sent in order to stimulate returns, along with a letter telling nonrespondents that the questionnaire has not been received and repeating the basic appeal of the original letter.
 3. **Seven weeks after the original mailing** – A third cover letter and questionnaire is sent by certified mail to the remaining nonrespondents.
4. This research will also make use of, and consider the following variables techniques in order to improve mail questionnaire response (Cooper & Schindler 2001; Kanuk & Berenson 1975).
 1. Keep questionnaire to be easy to read.
 2. Include return envelopes and prepaid postage.
 3. Provide information about the survey in a cover letter or advance notification.
 4. Promise of anonymity.
 5. Specify deadlines dates.
 6. Personalise all communication with the respondent.



7. Offer clear response directions.

In any large survey a small percentage of all questionnaires will be returned. The problem of questionnaire non-response bias must be addressed. Previous research (Filion 1975; Wallace & Mellor 1988) shows that non-respondents behave like late respondents. Hence, this study will employ an independent sample t- test to detect a significant difference between early and late respondents in order to imply non-response bias.

1.7.3 Measurement of Variables

1.7.3.1 Financial information in raising external funds

Financial information in raising external funds this study includes financial reports and financial ratios extracted from the financial statements. The common financial reports generated from the accounting systems of unlisted SMEs are the income statement and balance sheet. The income statement conveys the company's revenue, expense, and net income (or net loss) for a specific time period, which is very crucial for decision-makers. The balance sheet supplies information which helps users assess a company's ability to increase owners/managers wealth and remaining solvent.

The standard financial statements of SMEs do not include cash flow statement (Arnold et al 1984; DeThomas & Fredenberger 1985) and SMEs tend to limit preparation of financial reports to the statutory requirement (DeThomas & Fredenberger 1985). Therefore, the financial statements provided by the accounts typically do not include this information. Studies show that SMEs are more interested in cash and cash flow than reported earnings and assets (DeThomas & Fredenberger 1985; Nair & Rittenberg 1983). Making payroll and pay bill when they come due are the main concerns. Other reports such as age analyses of receivables, debt, and fixed



assets, and budgets, which are not on the standard financial statements, are also useful for the financial decisions.

Financial indicators extracted from financial statements are also considered useful by a number of studies on small business (Beal 2000; English 2001).

As a result, financial reports, which are on and out of the standard financial statements of SMEs, and financial indicators extracted from the financial statements are surrogate of financial information in raising external funds in this study.

1.7.3.2 Financial information in making long-term investments

The capital budgeting techniques are considered as financial information used in raising external funds in this study.

However, financial information has no financing advantage unless it is actually utilised in the financing decision. Therefore, financial information used in financial decisions (in this study) includes the variables measured by DeThomas and Fredenberger (1985) and Jackson (2001):

1. The preparation of financial information
2. Use of financial information
3. The quality of financial information
4. Meeting the needs of SMEs

1.7.3.3 Controlled variables:

1. Inter-industry effect - Since this study focuses only on the trading sector, there is no inter-industry effect.
2. Enterprise location – Since it is difficult to determine government regulations in different locations, all enterprises in the country were



included in the sample. However, enterprises located in special areas such as industrial estates (a type of free enterprise zone) where exclusive rules are applied will not be included in this study. The effect from enterprise location will be minimal, especially since all the SMEs are Thai.

3. Enterprise size – The SMEs studied will be restricted as to size of employment and fixed assets, as defined by the Thailand Ministry of Industry.
4. Life-cycle state – The effect of life-cycle state will be detected by testing the significance between ‘firm age’ (a surrogate of life cycle) and the variables examined in this study (Bernice 1994).

1.7.4 Data Analysis

The respondents in this study will only be the persons who actually make financial decisions for the firm. The scores on the Likert linear scale are aggregated to compute the mean observation for the SMEs use of accounting information.

1.8 Justification of the Research Issue

It is suggested that SMEs performance is influenced by a number of factors which include 1) a lack of demand for product or service, 2) poor management and/or administrative skills of the owner/manager, 3) a lack of experience in the particular industry, 4) insufficient capital invested by the owner, 5) an over-reliance on external borrowings, 6) poor record-keeping, and etc. (Brooks, Collings & Gonzales 1990). It is also implied, in the literature, that a poor accounting record-keeping and inefficient use of accounting information cause poor financing decision of SMEs and high failure rate. The ineffective use of capital budgeting techniques also makes the SMEs’ take of successful more difficult. Thus, the use of accounting records and capital budgeting techniques in financial decisions of SMEs has valuable implications for economic development, policy formulation, and program development, as SMEs are the foundation of Thailand’s economy. The overall performance of the SMEs is crucial to



Thailand's economic development. Moreover, since few SMEs studies have been done in Thailand, this study will fill a gap in the literature.

1.9 Outline of the Research (and Table of Contents)

The study is organized into nine chapters, as follows:

Chapter one: This chapter contains the background for the research, the research questions, the objectives, and an explanation of the study. The terms and concepts utilised in this study were defined. This chapter ends with the study's limitations.

Chapter two, three, four, five and six:

Research propositions are developed in these chapters, based on the research objectives and the literature which relates to these objectives.

Chapter seven: The research methodology utilised in the study is discussed. It details the development of the questionnaire, the data collection processes, and the analytical techniques used to test the hypotheses.

Chapter eight: The results and finding of the study are reported.

Chapter nine: The summary and conclusion are given with some suggestions for further research.

1.10 Limitations to Study

There was little research on the financial decisions of SMEs in Thailand or even in developing countries generally. Prior research in financial decisions concentrated on larger listed firms, and financial companies. Therefore, most of references in this study were based on research undertaken in developed countries.



Comparability was a problem in this study because of the differences between SMEs in developed and developing countries, in term of organizational, structural, environmental, and management variables, not to mention the definition of SMEs.

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