

## Small and Medium Enterprises: Critical Problems and Possible Solutions

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**Abstract:** Small and Medium Enterprises (SMEs) play a profound role in the economic development in many countries including Malaysia. However, due to an array of critical problems, many SMEs are unable to compete and sustain long enough in the marketplace. This scenario is worrying as SMEs form an essential economic component and are often considered as the engine of economic growth. In Malaysia, SMEs have been widely recognized as the backbone of Malaysian economic due to their strong contributions in promoting endogenous growth in industrial expansion and development. The significance of SMEs to the nation's economic survival makes a discussion on numerous issues impinging the success of SMEs highly relevant and timely. The aim of the study is to discuss the critical problems affecting the SMEs and the effects of such problems to the SMEs' success and economic sustainability. In addition, the paper offers some suggestive actions that can be performed by the SMEs in overcoming the identified problems. It is hoped that the paper may add to the growing literature on SMEs in general and specifically in a developing country's perspective. In view of the fact that SMEs are vulnerable to business failure, the actions suggested in the paper may offer some assistance to the SMEs in resolving internal weaknesses and help them become the organizations that are not only successful financially but also sustainable in the hostile business environment.

**Key words:** Accounting system, SMEs, organizational resources, business sustainability, internal organizational weaknesses

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### INTRODUCTION

Small and Medium Enterprises (SMEs) have been facing many sustainability issues despite having competitive products offered at attractive pricing schemes. The increased instances of business failure among the SMEs prompt a continual debate on the critical problems affecting the survival of the SMEs. Prior literature has documented evidence of internal organizational weaknesses that either partly or wholly contribute to this unfortunate phenomenon (Ismail, 2002; Duan and Kinman, 2000; Son *et al.*, 2006; Salikin *et al.*, 2014). Hence, an understanding on the internal problems among the SMEs is of a significant one as it may potentially offer useful insights to help resolve the issue. The main objective of the study is to offer a discussion that covers many significant areas affecting the sustainability of the SMEs. It highlights the key aspects that often receive serious attention and lead to extensive debate by many prominent scholars. The structure of the study proceeds in the following order. In the next section, the 4 critical problems that the SMEs are facing are identified and discussed. Next, the impacts of the problems on the survival of the SMEs are deliberated.

This is then followed by a discussion on the potential actions that can be implemented by the SMEs in an effort to improve the current situation. A conclusion ends the study.

### MATERIALS AND METHODS

**Problems in smes:** The literature on critical problems affecting the SMEs is quite abundant and can be segregated into several key points. In this section, four pertinent problems are identified and discussed.

**Lack of accounting knowledge:** It is generally acknowledged that accounting plays an important role in the day to day activities of an organization. In order to ensure the smooth flow of organizational activities, managers are expected to have a decent level of accounting knowledge and are also expected to be familiar with the different functions of accounting. It is posited that by having an adequate level of this knowledge, the managers may have a clear idea of the financing activities and are able to manage the business resources efficiently and effectively. Yet, according to Ismail (2002), SMEs are more likely to outsource their accounting work and

functions due to a serious shortage of accounting knowledge among the staff. In a related study, Salikin *et al.* (2014) discover that not many SMEs in Malaysia are adopting financial management tools in their organizational activities. The reason being that the SMEs are found to have a lack of internal accounting staff who are responsible in the accounting matters. Arguably, SMEs need to be aware of the accounting information and use it for better management control and decision making process in order to remain competitive in the corporate world (Jayabalan *et al.*, 2009). However, most of the managers do not have sufficient accounting knowledge and often pass the accounting function to other departments.

A study by Dang (2011) suggests that SMEs are having a shortage of accounting skills and a lack of infrastructure in order to implement accounting regulations and standards. Hence, hiring appropriate and qualified staff may help in preparing proper accounting records and practicing prudent financial management to ensure the sustainability and growing of SMEs (Salikin *et al.*, 2014). Marriott and Marriott (2000) find that financial awareness among the managers of SMEs varies considerably. What it means here is that some managers may have an adequate level of knowledge in financial matters, while others demonstrate a low level of understanding in such knowledge which in turn could bring serious consequences to the financial stability of the SMEs. In some other circumstances, not only the managers but also the directors are found to have a poor level of financial awareness. Consequently, they do not understand the information and the financial information produced is of low quality (Son *et al.*, 2006). The above-mentioned studies have indicated that a lack of accounting knowledge may bring detrimental impact to the financial viability of SMEs, since the managers and directors have both low levels of financial awareness and understanding of the accounting information.

**Lack of proper record keeping:** Smirat (2013) argues that good accounting practices are likely to bring significant improvements to the SMEs' operations. However, since the level of awareness on financial management among managers in SMEs is poor then improper keeping of accounting records can be anticipated. One of the reasons behind the fact that SMEs do not properly keep their accounting records is that there is no statutory requirement for the SMEs' financial information to be publicly disclosed. Although, this may indicate that there are no violations of the statutory regulations but somehow it demonstrates that SMEs are not being responsive to the importance and safety of accounting

records. Ideally, the preparation of accounting information must be in accordance with the accounting and financial reporting regulations and standards. This is to ensure that a good and reliable financial report is produced and is able to assist a multitude of users to make informed decisions by relying on the accurate accounting information (Smirat, 2013). However, Dang (2011) discovers that the SMEs often complain about the burdens imposed by reporting regulations and feel that they do not oblige to adhere to such regulations since they are just small enterprises. This misconception is partly attributed to the lack of awareness among the SMEs on the importance of accounting information to be prepared in accordance with the statutory regulations and standards.

**Lack of ICT usage:** The emergence of Information and Communications Technology (ICT) has changed the business environment considerably and impacted the manner in which business activities are being transacted. Hence, in response, organizations should no longer keep their business transactions manually. All information needs to be computerized to establish a fast and beneficial link with the customers, and the suppliers which can ease the business operations in terms of saving time and cost. The case is similar for the SMEs. They need to be equipped with the Information Technology (IT) knowledge to remain relevant in the current business environment. However, a significant number of literature indicates a low level of usage of ICT among the SMEs. The reasons justifying this occurrence are varied. In a study of 197 SMEs in Namibia, Rufaro *et al.* (2008) find that the ICT utilization among SMEs is very low because of the high maintenance cost and the cost of investment. A study in Australia by Breen *et al.* (2003) find that the major obstacles faced by the small businesses in implementing computerized system is that they claim ICT does not add any value to their businesses and thus there is no need for them to install such system.

A lack of ICT literacy and skills among the senior managers of the SMEs are also one of the major hindrances that slow down the migration of the computerized system (Duan and Kinman, 2000). Davis *et al.* (2009) in addition find that there are 4 major obstacles facing the small businesses in embarking on the computerized system. They stress that the function of the system is too complicated to understand, lack of accounting knowledge, overly expensive and the system does not meet their needs. The foregoing discussion on prior literature suggests that SMEs seem to prefer to record business transactions manually and keep the source documents in hard cover files rather than keeping the record electronically. In the Malaysian context,

Hashim (2015) finds that the level of ICT skills among 383 SME owners is relatively poor. Consequently, it leads to a slow and low level of ICT adoption. In addition, Hashim (2015) also discovers that the main reason for a lack of ICT usage among SMEs is that the respondents often see ICT as difficult to be implemented and choose to use the manual system instead. This perception is deeply rooted among the senior managers who often find ICT as a challenging and complicated system to comprehend.

**Limited financial resources:** According to Rufaro *et al.* (2008), SMEs do not only have limited resources in technology but also in financing their operations, marketing their products and having an inadequate budget for training their staff. Jasra *et al.* (2011) find similar problems in which SMEs often have insufficient funds particularly in developing and marketing their products. Given the status of a business environment where the competition is intense, SMEs need adequate financial resources to survive. To stay highly competitive in the marketplace, research needs to be done from time to time to cater the needs of the consumers. Thus, inevitably SMEs must have a bigger capital to invest in the research and development (R&D) projects in ensuring that their products meet the expectations of the customers and that the products' demands continue in the future. Any shortage in financial resources may hinder SMEs from growing. Senik *et al.* (2012) in addition argue that a lack of financial capability among the SMEs is one of the reasons for the inability of the SMEs to embark on computerized environment, as they could not afford buying the facilities needed.

SMEs in Malaysia are also found to have similar shortcomings. A study by Salikin *et al.* (2014) among others indicates that the survival of SMEs is challenging as competition is immense and financial viability remains at the unsatisfactory level. They claim that the financial weaknesses faced by the SMEs in Malaysia are largely due to a lack of capital, incomplete accounting records, poor financial performance, difficulties in getting financial support such as loans, high operational costs and poor collection of debts. A recent study by Nor *et al.* (2016) reports identical findings. Limited financial resources continue to be a major obstacle that adversely affects the development of SMEs in Malaysia as many investment projects with favorable returns could not be implemented. In addition, Nor *et al.* (2016) also attribute the failure of SMEs to survive to other influential factors such as a lack of professional skills, business competitiveness, insufficient supporting infrastructure and unfavorable government policy. These flaws impact the going concern of the SMEs and expose them to a high risk of business failure.

## RESULTS AND DISCUSSION

**Impacts of the problems on SMEs:** The discussion in the preceding section highlights the critical problems that the SMEs are facing. These problems arguably may bring negative consequences for the performance and sustainability of the SMEs. Due to a lack of accounting knowledge and the feeling of less accountable to prepare the accounting reports, the SMEs are likely to face problems in managing their costs, expenditure, cash flows and also having difficulties in getting appropriate information to support the monitoring and controlling systems (Son *et al.*, 2006). Also, appointing external independent accountants to perform the accounting functions, although may help in the proper maintaining of the accounting records but is likely to burden the SMEs with high additional costs (Salikin *et al.*, 2014) and also reduce the managers' awareness on the importance of financial information. High costs incurred could result in a negative effect on the turnover of the SMEs.

A proper maintaining of accounting information is unavoidable to SMEs (Davis *et al.*, 2009). As such, the SMEs need to ensure that they have a proper record keeping system which is in accordance to the promulgated standards and guidelines. If the SMEs fail to do just that, then the accounting information may not be able to show the true view of the financial performance and position of the SMEs. Accordingly, the information published is inaccurate, unreliable and irrelevant for decision making (Mukherji, 2002; Smirat, 2013). This makes it even more difficult for the SMEs to attract external financing sources (Amidu *et al.*, 2011). Moreover, the calculation of tax for SMEs may as well be affected since accurate financial accounting is paramount in the computation of tax (Smirat, 2013). The SMEs should utilize the accounting information that they have in making business decisions, business expansion and also in managing the organizational activities effectively.

With the rapid change of technology, the SMEs need to adopt the cutting edge technologies to sustain a competitive advantage (Jayabalan *et al.*, 2009). However, prior literature suggests that there are many SMEs still refusing to use ICT and the computerized system in their day to day operations due to many reasons (Duan and Kinman, 2000; Breen *et al.*, 2003). According to Tovar (2012), low adoption of technologies may affect the effectiveness of the company and may make it difficult for the company to remain competitive and achieve growth since IT is an enabling factor for the organizational success. Investment in technology especially the manufacturing technology could help the SMEs to reorganize the production, increase the quality of product

and produce innovative products (Zainun and Smith, 2011). Therefore, if the SMEs are disinclined to adopt and use such technology, then the benefits may not be exploited.

A lack of financial resources may bring serious restrictions to SMES in improving their production, upgrading their management system and in ensuring the survival of SMEs in the future (Salikin *et al.*, 2014). According to Arokiasamy and Ismail (2009), financial constraints often serve as the biggest obstacle facing the SMEs. Due to limited budget for example, the SMEs may not be able to provide sufficient training to develop skills and competencies among the employees. Hence, the employees are unable to improve their abilities to manage the organization and to cope with the rapid changes in the business climate. Moreover, due to the limited financial resources, SMEs could not afford to adopt the latest and advanced technologies which involve high investment expenditure to enhance their competitive edge (Senik *et al.*, 2012). To expand their businesses, the SMEs may need to obtain external capital as an alternative to growth. However, such an effort may increase the risk of bankruptcy if the organizations fail to meet the deadline of the debt payment (Salikin *et al.*, 2014).

**Areas for improvements:** Hiring qualified accountants: Human capital is a prominent element in the management and development of an organization, either in the public sector or the commercial entities. In ensuring that the organizational processes can be executed without much hassle, skilled and highly competent staff are very much needed. Hence, the SMEs should hire skilled and capable employees in various aspects especially in the accounting background to be responsible in observing the accounting functions in the SMEs. Hiring qualified accountants may contribute to solve the problems in the lack of accounting knowledge, as they have the required expertise and have the capability to execute the accounting work. Not only preparing and producing the financial statements, qualified accountants also have the knowledge of exploiting the accounting information for the benefit of the SMEs. This in turn may provide important input that can be useful for managers in improving the operation, increasing the efficiency of the organization and providing support for decision making. In other developing countries, the SMEs are beginning to be selective in hiring new employees to work in their organizations. Most SMEs in Ghana as an example have been employing at least degree holders and chartered accountants to handle their accounting information, as

they are becoming more aware on the importance of accounting and financial information to the success of the SMEs (Amidu *et al.*, 2011).

**Heighten the awareness of accounting function:** The extant literature suggests that most SMEs are not aware of the importance of accounting and its usage (Davis *et al.*, 2009; Marriot and Marriot, 2000; Son *et al.*, 2006). This is very much contradictory to the expectations that the SMEs should maintain a proper accounting system, which has been enunciated as a critical success factor of the SMEs. Poor financial management practice for example is often associated with small and medium-sized business failure (Gobeli and Seville, 1984). There are many advantages of having a proper accounting system in an organization. Jaffar argue that an organization should have a good accounting system rather than merely complying with minimal government regulations to survive and grow with the economy. Ninlaphay and Ussahawanitchakit (2011) concur with the opinion of Jaffar that accounting plays an important role in the success of the SMEs, as it has the ability to highlight and measure the financial performance and position in an objective manner. This in turn may help the SMEs to secure external financing (Amidu *et al.*, 2011). According to Davis *et al.* (2009), proper accounting system for small businesses is critical as it enables the company to evaluate the performance of the company, pay its obligations and provide the information for planning and control. In the context of SMEs, a proper accounting system provides assistance in terms of managing short-term problems in critical areas such as costing, controlling expenditure and managing cash flows, by providing information to support the monitoring and controlling activities (Senik *et al.*, 2012).

**ICT adoption in SMEs:** SMEs need to move in parallel with other types of business in adopting ICT in their organization. ICT brings considerable benefits such as time saving opportunity, reduced salaries expenses, increased quality of products and developed innovative products (Jones *et al.*, 2003; Khatibi *et al.*, 2003; Amidu *et al.*, 2011; Ramli *et al.*, 2015; Afolayan *et al.*, 2015). In relation to the accounting environment, the SMEs may employ appropriate accounting software not only to reduce the work to be done and minimize the mistakes but also to serve as a systematic mechanism for maintaining proper accounting records. In addition, Malaysia is currently in the introductory period of implementing Goods and Service Tax (GST). Thus, the need for ICT is becoming a must and not anymore a choice since the GST regards the SMEs as tax collectors.

They should have a proper documentation system to claim the GST refunds and also for the purpose of making GST payments. Many accounting softwares are available in the market such as MYOB, MR Accounting and UBS Accounting System which have been used by many SMEs. By adopting the readily available software offered in the market that can tailor to their needs, the cost of developing their own system can be avoided and this, therefore, may save some costs (Tan and Eze, 2013). Relying on the traditional recording system is no longer adequate as the volume and complexity of business transactions have increased. By employing the ICT, the operational efficiency can be improved since the ICT is able to synchronize the data between suppliers and customers and thus information needed can be made available online at all time (Ramli *et al.*, 2015). Although, migrating to a computerized environment may potentially incur some costs, particularly at the initial level but the benefits that the SMEs may enjoy often outweigh the costs. The cost incurred in installing the software should be viewed as an investment and not merely as an expense since many advantages may be gained such as providing better profitability, market share and customer service (Goswami and Sarangdevot, 2010). Hence, it is a good move for the SMEs to start investing in ICT to bring about improvements to their organizations as a way of responding to the call for a more comprehensive business-oriented information to be prepared and disseminated at fast speed.

### CONCLUSION

In general, the discussion has identified four critical problems that are often encountered by the SMEs that might potentially hamper them from staying competitive in the business environment. Despite the daunting challenges, the SMEs remain one of the drivers in the economic development of a country. Hence, their survival needs to be protected. However, synergizing SMEs is not going to be easy. The SMEs need to change and arm themselves with the required knowledge, and constantly keep abreast of the latest technologies in the market. This paper has offered some recommendations that may be of significant interest to the SMEs to overcome the critical problems. Financial supports from the government and the financial institutions are considered inevitable and remain vital for the success of the SMEs. It is hoped that this paper provides valuable insights to the SMEs as an attempt to assist them in improving their current practices, so that their organizations are successful and sustainable.

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