

**ANTECEDENT OF EXTENT OF ACCOUNTING
INFORMATION USAGE AND THE INFLUENCE OF
ACCOUNTING INFORMATION USAGE ON FINANCIAL
PERFORMANCE.**

By

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**Research report in partial fulfillment of the
requirements for the degree of MBA**

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Specially dedicated to

**My mothers *Hajah Fatimah and Hajah Shamsiah,*
My beloved husband, *Roslan Mansor,*
daughters *Nurhanis Amira and Nurhanna Aqila,*
and son *Ikmal Haris***

***Thank you very much for your patience and support
throughout the period of my study.***

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TABLE OF CONTENTS

	Page
ACKNOWLEDGEMENT	iii
TABLE OF CONTENT	iv
LIST OF TABLES	ix
LIST OF FIGURES	x
ABSTRAK	xi
ABSTRACT	xii
Chapter 1 Introduction	
1.1 Introduction	1
1.2 Background of the Study	2
1.2.1 <i>Problem for SMEs</i>	4
1.2.2 <i>Financial Performance of SMEs</i>	5
1.2.3 <i>Financial Government Support Program</i>	5
1.2.4 <i>The Influence of Gender to Accounting</i>	
<i>Information Usage</i>	8
1.2.5 <i>The Influence of Education Level and Accounting</i>	
<i>Training to Accounting Information Usage</i>	9
1.2.6 <i>The Influence of Entrepreneurial Traits to</i>	
<i>Accounting Information Usage</i>	10
1.2.7 <i>The Influence of Business Age to Accounting</i>	
<i>Information Usage</i>	11
1.3 Problem Statement	11
1.4 Research Objectives	13
1.5 Research Questions	14
1.6 Definition of Key Terms	14
1.7 Significance of the Study	18
1.8 Organization of the Remaining Chapters	18

Chapter 2	Literature Review	
2.1	Introduction	19
2.2	Literature Review	
2.2.1	<i>Small Enterprise or Small Business</i>	19
2.2.1.1	<i>Definition and Profile of SMEs</i>	19
2.2.1.2	<i>The Roles of SMEs</i>	22
2.2.1.3	<i>Key Internal Weaknesses in SMEs</i>	22
2.2.2	<i>Government Financial Support Programmes</i>	25
2.2.3	<i>Accounting Information</i>	25
2.2.4	<i>Entrepreneur's Characteristics</i>	31
2.2.4.1	<i>Gender</i>	31
2.2.4.2	<i>Formal Education Level</i>	37
2.2.4.3	<i>Formal Accounting Training</i>	38
2.2.4.4	<i>Entrepreneurial Traits</i>	39
2.2.5	<i>Organizational Characteristic</i>	43
2.2.5.1	<i>Business Age</i>	43
2.2.6	<i>Financial Performance</i>	43
2.3	Theoretical Framework	44
2.3.1	<i>Gap in the Literature</i>	44
2.3.2	<i>Justification of Framework</i>	45
2.4	Development of Hypotheses	46
2.4.1	<i>The Extent of Accounting Information Usage</i>	46
2.4.2	<i>Formal Education Level</i>	46
2.4.3	<i>Formal Accounting Training</i>	47
2.4.4	<i>Gender</i>	48
2.4.5	<i>Entrepreneurial Traits</i>	49
2.4.6	<i>Business Age</i>	50
2.4.7	<i>Financial Performance</i>	50
2.5	Summary	51

Chapter 3	Methodology	
3.1	Introduction	52
3.2	Research Design	52
	3.2.1 <i>Type of Study</i>	52
	3.2.2 <i>Study Setting</i>	52
	3.2.3 <i>Subject Respondents</i>	53
	3.2.4 <i>Time Horizon</i>	53
3.3	Variables	53
	3.3.1 <i>Independent Variables</i>	53
	3.3.2 <i>Dependent Variables</i>	54
3.4	Population and Sample	54
3.5	Procedure	55
3.6	Measure	56
	3.6.1 <i>Gender</i>	56
	3.6.2 <i>Education Level</i>	56
	3.6.3 <i>Accounting Training</i>	57
	3.6.4 <i>Entrepreneurial Traits</i>	57
	3.6.5 <i>Accounting Information</i>	58
	3.6.6 <i>Financial Performance</i>	59
3.7	Data Analyses	
	3.7.1 <i>Statistical Analysis and Hypothesis Testing</i>	60
	3.7.2 <i>Statistical Technique</i>	60
	3.7.3 <i>Factor Analysis</i>	61
3.8	Summary of Statistical Tools	61
Chapter 4	Results of the Study	
4.1	Profile of Respondent	62
	4.1.1 <i>Position in the Company</i>	63
4.2	Goodness of Measure	65
	4.2.1 <i>Factor Analysis</i>	65
4.3	Reliability Analysis	68

4.4	Descriptive Analysis for Variables	69
	4.4.1 <i>Correlation</i>	70
	4.4.2 <i>Business Age</i>	71
	4.4.3 <i>Education Level</i>	72
	4.4.4 <i>Gender</i>	73
	4.4.5 <i>Government Financial Support</i>	74
	4.4.6 <i>The Usage of Accounting Information</i>	74
	4.4.7 <i>Entrepreneurial Traits</i>	77
4.5	Hypothesis Testing	79
	4.5.1 <i>Difference Usage of Accounting Information</i>	79
	4.5.2 <i>Regression Analysis</i>	80
	4.5.3 <i>Independent Variables and Statutory</i> <i>Accounting Information</i>	82
	4.5.4 <i>Independent Variables and Budgetary</i> <i>Accounting Information</i>	83
	4.5.5 <i>Independent Variables and Additional</i> <i>Accounting Information</i>	84
	4.5.6 <i>Accounting Information and</i> <i>Financial Performance</i>	85
4.6	Summary of Result	86
Chapter 5	Discussion and Conclusion	
5.1	Recapitulation and Summary	88
5.2	Discussion and Findings	89
5.3	Implications	93
5.4	Limitations	95
5.5	Recommendation for Future Research	96
5.6	Conclusion	97
	Bibliography	98

Appendices

Appendix A	Questionnaires	105
Appendix B	SPSS Printout of Frequencies	116
Appendix C	SPSS Printout of Factor Analysis	122
Appendix D	SPSS Printout of Reliability Analysis	132
Appendix E	SPSS Printout of Descriptive Statistics	139
Appendix F	SPSS Printout of Pearson Correlation	140
Appendix G	SPSS Printout of Friedman Test	142
Appendix H	SPSS Printout of Regression Analysis	144

LIST OF TABLES

Table 1.1	Malaysia SMEs Performance in 2003 and 2005	6
Table 3.1	List of Entrepreneurial Traits	57
Table 3.2	Summary of Statistical Tools	61
Table 4.1	Profile of Respondents	62
Table 4.2	Sample Profile of Respondents	64
Table 4.3	Factor Analysis: Factor Loading for Respondent Entrepreneurial Traits	66
Table 4.4	Factor Analysis: Rotated Component Matrix for Accounting Information Used	67
Table 4.5	Result of the Reliability Test	68
Table 4.6	Descriptive Statistic for Major Variable	69
Table 4.7	Pearson Correlation	71
Table 4.8	Business Age and Accounting Employee	72
Table 4.9	Education Level and Accounting Employee	73
Table 4.10	Gender and Education Level	73
Table 4.11	Gender and Government Funding	74
Table 4.12	Percentage Usage of Accounting Information	75
Table 4.13	Accounting Purpose	75
Table 4.14	Accounting Planning	76
Table 4.15	Opinion Regarding the Usefulness of Accounting Information	77
Table 4.16	Rank of Entrepreneurial Traits by Friedman Test	78
Table 4.17	Friedman Test for Accounting Information	79

Table 4.18	Friedman Test for Item in Accounting Information	80
Table 4.19	Result of Regression Analysis for Extensive Usage of Statutory Accounting Information	82
Table 4.20	Result of Regression Analysis for Extensive Usage of Budgetary Accounting Information	83
Table 4.21	Result of Regression Analysis for Extensive Usage of Additional Accounting Information	84
Table 4.22	Result of Regression Analysis for Extensive Usage of Accounting Information by SMEs on Financial Performance	85
Table 4.23	Summary of Hypotheses Result	86

LIST OF FIGURES

Figure 1.1	SME Contributions to the Malaysian Economy	6
Figure 2.1	SMEs Definition Based on Number of Employees	20
Figure 2.2	SMEs Definition Based on Annual Sales Turnover	21
Figure 2.3	Theoretical Framework	45

ABSTRAK

Industri Kecil dan Sederhana adalah merupakan tulang belakang kepada pembangunan ekonomi di Malaysia. Kajian terdahulu telah membuktikan bahawa IKS mengalami pelbagai masalah dalam memajukan perniagaan mereka dan salah satu daripada masalah tersebut adalah kelemahan dalam menguruskan kewangan perniagaan. Kajian ini bertujuan untuk menentukan tahap penggunaan maklumat perakaunan di kalangan IKS dan menentukan tujuan penggunaan maklumat perakaunan tersebut. Kajian ini juga bertujuan untuk menentukan ciri-ciri organisasi dan ciri-ciri usahawan seperti jantina, usia perniagaan, tahap pelajaran atau latihan formal perakaunan dan sifat-sifat pengusaha kecil yang berjaya yang dapat dihubungkan dengan darjah maklumat perakaunan oleh IKS. Kajian ini menumpukan kepada perniagaan berskala kecil di kawasan tengah Seberang Perai Pulau Pinang. Hasil keputusan dari kajian ini ada menunjukkan perhubungan positif di antara tahap pelajaran dengan darjah penggunaan maklumat perakaunan oleh IKS. Faktor seperti jantina, latihan perakaunan dan ciri-ciri personaliti pengusaha hanya mempunyai hubungan dengan jenis maklumat perakaunan tertentu sahaja. Usia perniagaan didapati tidak mempunyai perhubungan dengan darjah penggunaan maklumat perakaunan oleh IKS. Juga didapati tahap penggunaan maklumat perakaunan ini mempunyai hubungan dengan prestasi kewangan organisasi. Keputusan kajian ini menjadi asas dalam memahami ciri-ciri organisasi dan sumbangannya kepada darjah penggunaan maklumat perakaunan oleh IKS.

ABSTRACT

Small and Medium Enterprises are the backbones on Malaysian economy. Studies have indicated that SMEs encounter financial difficulties due to major internal weaknesses in financial management of the businesses. This study examines the extent of usage of accounting information and types of accounting information that used by SMEs. This study also examines whether specific organizational characteristic and entrepreneur characteristics such as gender, education level, accounting training, and entrepreneurial traits have positively relation to the extent of accounting information used. This study was done on selected small businesses in Seberang Perai Tengah Pulau Pinang. The result from this research supported the relationship whereby education level to be positively related to the extent of accounting information used. On the other hand, gender, accounting training and entrepreneurial traits has relationship to certain type of accounting information usage only. Business age was found insignificant relationship with the extent of accounting information used by SMEs. Also, it is found that the extent of accounting information usage has significant relationship with financial performance of the organization. The result of this study gave a better understanding of the entrepreneur's and organizational characteristics and the contribution towards the extent of accounting information used by SMEs.

Chapter 1

INTRODUCTION

1.1 Introduction

Small and Medium Enterprise (SMEs) play a significant role in national economic system of both developed and developing countries. SMEs contributes to the welfare of the countries by creating employment, form a precursor for many MNCs and large corporations, stimulate competition in the economy, feed large organization with raw materials, parts and semi-finished goods as well as distribute their offerings (Ndubisi, 2006). SMEs innovate and generate export opportunity and are a source of future successful medium and large scale business ventures. For more mature countries in the region such as Korea and Taiwan, the government has increasingly acknowledged the importance of SMEs to strengthen the flexibility of the country. In Taiwan, SMEs have also been given high priority in the process of economic development and play a prominent role through emergence of a network-based industrial system (Harvie & Lee, 2003).

The important role the SME sector contributes to the Malaysian economic development is well recognized and is considered to be the backbone of industrial development. SMEs account for 99.2 percent of total business establishments, contributed 32 percent of real gross domestic national product (GDNP) and 19 percent of total exports and provide 5.6 million employments (Utusan Malaysia, 28 November 2007, 16 July 2007 and SME Annual Report 2006). According to Department of

Statistics (the 2000 census), there were total of 20,445 active establishments in the manufacturing sectors in which 18,271 or 89.3 percent of them are SMEs. The textiles and apparel sector accounted for around 17 percent of the total, making it the largest SME sector, followed by food and beverages with more than 14 percent, metal and metal products accounted for 14.3 percent and wood and wood products accounted for 13.6 percent (Department of Statistics, <http://www.statistics.gov.my>). As for service sectors, there were 192,527 establishments and 96.8 percent of them were SMEs. Most of the companies were in the retail and wholesale (88%), followed by education and health (4.4%), professional services (2.9%) and transport and communication (2%).

According to Harvie and Lee, (2003) SMEs broad policy issue in East Asia such as access to finance improvement of the business environment, strengthening the management capabilities and access to markets appear not to be substantially different from those in other countries in this region. According to Philippe (1992), SMEs business, like those in Korea, still faces key problems in entrepreneurship and human resources management, banking and finance, technology and expertise, subcontracting, and marketing. While in Japan as developed country, Helms (2003) highlights the political, economic, regulatory, educational, social and cultural issue as the major entrepreneurial problems and it is believed once implemented would establish the better foundation for Japanese entrepreneurship.

1.2 Background of Study

The globalization process brings both opportunities and challenges to SMEs in Malaysia. The main opportunities for SMEs come from leveraging off free trade area

(FTA) which lower both tariff and non-tariff barriers in market globally. This gives SMEs an opportunity to enter new markets for their products and greater access to technology, capital, labour and intermediate inputs. However, a freer and more liberalized trading environment also brings new competition in the form of new players who may threaten traditional market shares. Increasing international trade, rising environmental standards in global supply would cause SMEs to increase their investment in better technology and standard. Thus SMEs in Malaysia face the challenges to raise the overall level of competitiveness if they are to maintain domestic market share and to penetrate into new external market (SME Annual Report 2006).

The purpose of this exploratory study is explore the lack of accounting usage among SMEs that lead them to few SMEs problems such as difficulties in obtaining fund from financial institutions and poor financial analysis for decision making. Generally, there is several usage of accounting information. The most common of accounting information usage is to evaluate company's business performance. The other usage is to assist in evaluation of capital investment projects decisions (Holmes & Nicholls, 1988), which means helping entrepreneurs to decide in financing and investing in business expansion. In addition, Ingram, Albright, Baldwin and Hill, (2005) explain decision making in operation planning and Van Auken (1993) recognized financial ratios; which are one of additional accounting information element, as a predictor of bankruptcy measurement.

Also, this research will examine the influence of gender, education level, accounting training, entrepreneurial traits and age of the business to the usage of accounting information in small business. Entrepreneur that manages to obtain

government financial support also will be examined their usage of accounting information as a control item. Lastly, the relation between the usage of accounting information and the financial performance of the business will also be determined.

1.2.1 Problem for SMEs

In spite of their roles and contributions to economic growth, employment and exports, literature has documented many barriers faced by SMEs in Malaysia. Salleh and Ndubisi (as cited in Ndubisi, 2006) and Small and Medium Industries Development Corporation (SMIDEC) (2004) have listed a few obstacles found by Malaysian SMEs; these include low level technological capabilities, low level research and development (R&D), substantial orientation towards domestic market and limited sources of funds. Studies by Abdullah (2002) has found that, the factors including small capital investment and low access in borrowing, low level expert abilities and in raw material, low access to needed infrastructure and low expertise in technical and management knowledge. The Bank Negara survey conducted in 2003, revealed that the SMEs participated have ranked competition from bigger players, not able to obtain loan, not able to source skilled labour, competition from new entrant and lack of government support as their problem.

Capital or credits is one of the major problems faced by small industries in Malaysia. According to the past research done in 1992, 71 percent of the SMEs respondents in Malaysia have announced that the major problem for them is to obtain finance or credits facilities from banks and other financial institutions (Abdullah, 2002). Generally, this is the most common problem for developing countries faced by SMEs. The reason that their application is being rejected is due to lack of collateral and track

records. Most of these SMEs did not have appropriate accounting system that can be the prove record of their application. The lack of appropriate accounting system has shown that SMEs either lacks of financial management abilities or they have inadequate accounting education.

1.2.2. Financial Performance of the SMEs

One of the usages of accounting information is to evaluate the financial performance of the business (Ingram, et al., 2005). Accounting information is analyzed to measure the ability of the business in its ability to use its resources effectively and efficiently. A business that is able to use accounting information effectively is believed to be able to make a right decision making and subsequently be able to perform well in business (Van Auken, 1993).

1.2.3 Financial Government Support Program.

Since SMEs in Malaysia only contribute 32 percent GDP over 99.2 percent of total establishment compared to 40 percent GDP in other regional economies such as Thailand, Taiwan and Korea, this is suggesting that there is a big room for Malaysian SMEs to expand their role (SME Annual Report 2006). Additionally, these numbers also did not show much increment compared to 2003 as shown below:

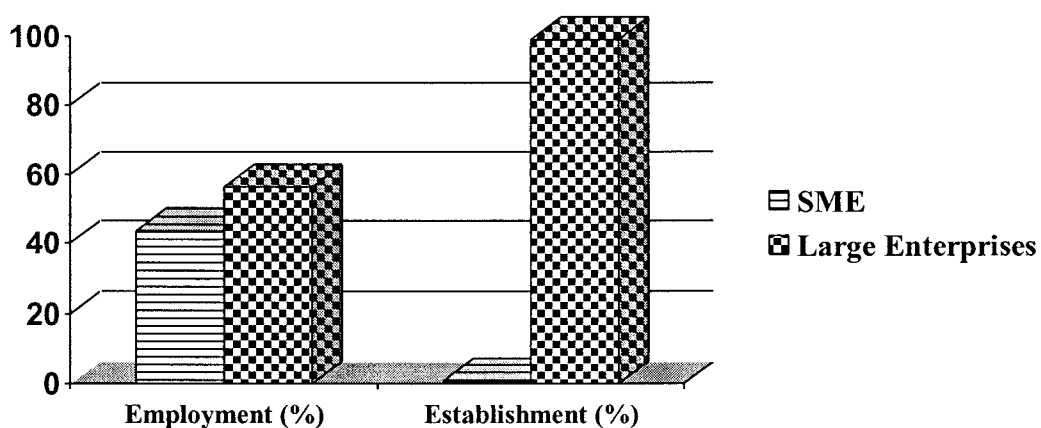
Table 1.1

Malaysia SMEs Performance in 2003 and 2005

Macro Performance of SMEs	2003 (%)	2005 (%)
SMEs' contribution to GDP	31.9	32.0
SMEs' contribution to employment (excl. Govt.)	55.8	56.4
SMEs' share of total exports	18.9	19.0

Source: SME Annual Report 2006

Similarly, productivity levels in the SMEs were found to be significantly lower than those of large enterprises as they generated an average value added per employee of just RM14,740; far lower than the RM47,830 generated by large enterprise (National SME Development Council, 2006). By prioritizing SMEs development, the Government aims to increase SMEs contribution to GDP from 32 percent to 37 percent and their total exports to increase from 19 percent to 22 percent and to employ over 6.2 million workers by 2010 (BNM Press Statement, 2007 and SME Annual Report 2006). Figure 1.1 below shows the SMEs contribution to Malaysia economy compared with larger enterprise.



Source: SME Annual Report 2006 (by Bank Negara Malaysia)

Figure 1.1 SME contributions to the Malaysian economy

Since SMEs contribution to the national economy is still relatively small, the Government has made the development of SMEs a high priority area. This is reflected in the national development agendas, namely the Ninth Malaysia Plan (9MP) and the Third Industrial Master Plan (IMP3), in which the key strategies for SME development is outlined for 2006-2010 and 2006-2015 periods respectively (National SME Development Council, 2006). From 9MP, a number of training programmes for SMEs were implemented to improve their resource planning, management capability, financial management and human resource development as well as upgrading their marketing and technical skills. Various grant and loan schemes were provided for business planning, product and quality improvement as well as marketing and promotion and the adoption of information and communications technology (ICT) processes.

In term of ensuring adequate funding for SMEs, the Government in 9MP has expanded funds, covering soft loans and grants to facilitate the establishment of new and upgrading of existing businesses. In addition, the SME Bank was established in 2005 to provide comprehensive financing packages to meet the various financial needs of SMEs. For venture capital, the Malaysia Venture Capital Management Bhd (MAVCAP) and the Malaysia Technology Development Corporation (MTDC) has continuously provided early stage financing to potential start-up companies that involve in high-technology activities (Chapter 4, Ninth Malaysia Plan, 2006).

However, in order to obtain these funding, these government bodies still impose some certain rules for entrepreneurs to follow. Selected entrepreneurs normally have proper accounting system, are able to pay their monthly credits and have a good record

with banking institution. They also showed some improvement in their financial performance. Other important criteria to the selection process are: a good business proposal, success in the entrepreneur personality test, training and evaluation test. Furthermore, some of these bodies such as Perbadanan Usahawan Nasional Berhad (PUNB) in their Projek Usahawan Bumiputera Dalam Bidang Peruncitan (PROSPER) scheme, only allowed entrepreneur with certain education level to apply for their service. Therefore, these factors such as proper accounting information, adequate education level and entrepreneurial traits of the owner are an important measurement to determine the financial performance of the SMEs.

1.2.4 The Influence of Gender to Accounting Information Usage.

Studies on entrepreneurs have generally focus on men, but with the increasing participation of women in the economic development of a country, interest in women's involvement in business is gradually gaining the attention of academics as a research area. Although the contribution of women in business has been recognized, little research has been done on their management practices, particularly in Malaysia (Arifin, 1992). Most existing literature on Malaysian business women have focused on their roles, contributions and other social issues. But, how do women manage their business? What are their management practices? What problems do they face in managing their business? What motivates them to start their own business? What are their reasons for starting their own business? These critical questions identify the key issues facing women in business, and thus provide the foundation in developing appropriate strategies to enhance women involvement in business.

Cuba, Decenzo and Anish (1983) found that most successful female entrepreneurs delegate most of their routine business activities and allow their employees to handle tactical decisions. These findings suggest that women entrepreneurs do not give adequate attention to the planning and organizing skills. Most researchers had found that women entrepreneurs are unsure as to what information system to use, therefore financial and operational monitoring would tend to be weak. The result is poor control and continued weakness in profitability and resource position (Chaganti, 1986). This is happened because women entrepreneur ranked leading as the most important management activity compared to organizing, planning and controlling (Arifin, 1992). This giving a meaning that women entrepreneur put a first priority on monitoring their employee rather than other business activities.

In this research, we will study how far the past research statement is true in saying that women is weak in financial skills or understanding the accounting information.

1.2.5 The Influence of Education Level and Accounting Training on Accounting Information Usage.

In a broad sense, accounting is the process of identifying, measuring and communicating economic information about the organization for the purpose of making decision and informed judgments (Marshall, McManus & Viele, 2007). The users of accounting information include the management of the entity or organization; the owners of the organization, potential investors in and creditors of the organization; employees; and various federal, state and local government agencies that are concerned with

regulatory and tax matters. Accounting information is very important for entrepreneurs and a lack of understanding or confusion that results from understanding financial statements would be very frustrating. Therefore, education or training in accounting information or financial analysis is very important in order to understand the financial position of the business. The failure of interpreting the accounting information may result in inaccurate decision making and subsequently resulting poor financial position of the business (Van Auken, 1993).

1.2.6 The Influence of Entrepreneurial Traits to Accounting Information Usage.

Not every entrepreneur is able to bring his/her business into a successful venture. This fact has attracted many experts who then tried to analyze what are the factors that set the successful entrepreneur apart from the others. Kusuma (2000) has listed the first character of successful entrepreneur is passion and self determination that will drive the entrepreneur to be persistence in building his/her company. The second character is a clear vision on where he/she wants to take the company. The third character is competency in human relations where he/she is able to motivate his employees to move in the same direction, while nurturing creative spirit among them. Next character is self-awareness that will help the entrepreneurs to understand his personality traits and how these traits will affect his/her decision making or other people. He/she also have to possess technical knowledge on physical process which means a deep knowledge about the market which his/her industry operates. Finally, a success entrepreneur always tries to be one step ahead of his competitors through superior customer service.

From the characteristics listed above, we can conclude that successful entrepreneur is the person who will do what ever he/she can in every technical and management area in order to sustain his/her business in this competitive environment. He/she will also make sure that his/her business will be success or at least compatible to the others. That's means the uses of accounting information in decision making process among the successful entrepreneur cannot be deniable as one of the success factor of his/her business.

1.2 7. The Influence of Business Age to Accounting Information Usage.

Holmes and Nicholls (1988) indicate that younger enterprise tend to prepare more accounting information compared to older enterprise. This statement is true as more and more young people nowadays are getting interested to start their own venture. These new generation are more educated compared to older entrepreneurs in ten years ago and they realize the importance of accounting information in their daily operation. Therefore, in this research we will study the relationship of business age to the extent of usage of accounting information.

1.3 Problem Statement

Even though SMEs have grown in performance from year to year, some factors still need extra attention such as access to export market, inadequate technological capabilities and low adoption of enabling technology (Chapter 4, Ninth Malaysian Plan, 2006). This problem has resulted from low ability in business expense as their constraint is obtaining funds to finance their expansion and business development (Utusan

Malaysia, 16 July 2007). As cited by many authors and researchers, (Abdullah, 2002 and Salleh & Ndubisi (as cited in Ndubisi, 2006)) low in capital investment and low access in borrowing has resulted due to the unwillingness of banking institutions to lend credit to SMEs. Commercial banks consider SMEs as high risk ventures and often reluctant to lend them without adequate collateral which many SMEs don't have. Also, poor book keeping is one of the reasons on why banks' loan, micro financing and free interest loans are often inaccessible for SMEs (Ndubisi & Saleh (as cited in Ndubisi, 2006)). Book keeping management is very important for financial institution as it can be a proven record on the ability of the entrepreneur on how to manage their financial to run their business (Abdullah, 2002).

Why does SME engaged in poor book keeping? How far is this statement true and how many of the entrepreneurs nowadays really uses accounting information in their daily operation? Is that true that SMEs that have appropriate accounting information will easily obtained the fund from banking institution apart from collateral issue?

Does accounting information really help entrepreneur to monitor their business performance? And is true that an entrepreneur who has proper accounting information will be more successful than others who are not?

Government entrepreneurial bodies such as SMIDEC, Majlis Amanah Rakyat (MARA) and (PUNB) has introduced several incentives to assist entrepreneurs to solve their problem and being ensuring that they would be able to obtain sufficient funding. They also have provided training to equip the entrepreneurs with the required skills and provide knowledge in keeping proper records and financial management (<http://www.smidec.gov.my>, <http://www.mara.gov.my>, <http://www.punb.com.my>). Is

financing the business, lack of management skills such as financial analysis or the entrepreneur's attitude contributed to the failure of their business? The success of their business is much more depending on factors like capital investment, management and technological expertise and their own entrepreneurial traits they have. Are their entrepreneurial traits affecting their willingness to use more accounting information in their daily business operation?

This research will also determine whether demographic factors such as gender, business age, education level and accounting training affect the willingness of the entrepreneur and his/her decision to use more accounting information.

1.4 Research Objectives

Objectives are as follows:

- 1) To determine whether the extent of types of accounting information usage used by SMEs to make business decisions have a significant relationship with their financial performance.
- 2) To examine whether demographic factors of the entrepreneur (gender, education level), accounting training and entrepreneurial traits have a significant relationship to the extent of usage of accounting information.
- 3) To determine whether business age have a significant relationship to the extent of the usage of accounting information.

This study is based on an examination of a sample of small business operating in the middle of Seberang Prai area of Penang State. Because the study is exploratory in

nature, it does not attempt to identify any entrepreneurial and managerial abilities associated with the extent of usage of accounting information in decision making, as this is an initial investigation to study the extent of usage of accounting information by SMEs.

1.5 Research Questions

This study attempts to answer the following questions:

- (i) Is there any significance relationship between the extent of accounting information usage used by SMEs to make business decisions and SMEs financial performance?
- (ii) Do demographic factor such as gender and education level; accounting training and entrepreneurial traits have significant relationship to the extent of types of accounting information usage used by SMEs?
- (iii) Does business age has significant relationship to the extent of types of accounting information usage used by SMEs?
- (iv) Which specific entrepreneurial traits are most contributive to the decision of the usage of accounting information?
- (v) Which type of accounting information is widely been used by SMEs?

1.6 Definition of Key Terms

It is important that the key terms or dimensions of variables be used in this study are introduced and are clearly defined. The entrepreneur's characteristics are the entrepreneur demographic factors (namely gender, education level and accounting training) and entrepreneurial traits. Organizational characteristic is business age.

Financial support from government will be a control item. Financial performance will be measured by annual sales turnover and annual profit. Accounting information will be measuring statutory accounting, budget accounting and additional accounting. The definitions of key terms will be explained further in following.

Gender – This research will measuring male and female entrepreneur's in term of their usage of accounting information. Based on research done by Tamar (2002), female entrepreneurs rated their financial skills the lowest while Chaganti (1986) mentioned that female entrepreneurs have difficulties in managing their finance. Therefore, it is predicted that female entrepreneurs used less accounting information in their business compared to male entrepreneurs.

Education Level – Education in this research is the formal education received by entrepreneurs. Based on research done by Ball and Shark (1995), entrepreneurs listed finance and accounting knowledge as the most important knowledge and these entrepreneurs have at least college education. Subsequently, higher education level in this research is from college education (with certificate qualification) and above.

Accounting Training – Holmes (1991) indicated in his study that training is positively related to the extent of preparation of accounting information which giving a meaning that entrepreneurs who have attended accounting training course tend to produce more accounting information than those having less training. In this research, higher

accounting training will be measured by entrepreneurs who attend more than three times of accounting training in the last three years.

Entrepreneurial Traits (ET) – Entrepreneurial traits are the distinguishing personal characteristics of an entrepreneur that helps to identify, tell apart, or describe recognizably or a distinguishing mark on an entrepreneurs that distinguish him/her to the others (Daft, 2004). In this research, the higher the score of entrepreneurial traits, demonstrate that the respondents share many of the characteristics of successful entrepreneurs. Subsequent, list of entrepreneurial traits will be elaborated further in chapter two.

Business Age - Holmes and Nicholls (1988) indicated that in their study that the extent of preparation of accounting information is influenced by the age of businesses. In this research, older business is the business that has been operated six years and above and younger business is the business that have been operated below than five years.

Accounting Information (AI) – Accounting information is a primary tool for entrepreneurs to make affirmation about past performance, current conditions and future prospects of the business (Ingram, et al., 2005). In this research it will focus on three types of accounting information which are statutory accounting, budgetary accounting and additional accounting as study used by Holmes and Nicholls (1988).

Statutory Accounting Information – The statutory or “legal” kind of accounting information; such as balance sheet, profit and loss statement and cash flow statement for both internal and external user. Additionally, tax return is included as it is a compulsory statement to meet legal requirement of Inland Revenue.

Budgetary Accounting Information – The accounting information that is used to assist in decision making process for the use of internal user. Examples such as budgeted profit and loss statement, budgeted cash flow and variance report or standard costing.

Additional Accounting Information – The accounting information that can further enhance the effectiveness of decision making by entrepreneurs. Examples such as ratio analysis, inter-firm comparison, industry trends, breakeven analysis and job costing report.

Financial Performance - Financial performance will be measured by annual sales turnover and annual profit following the research done by Haron, Yahya, Ismail and Hassan (2001).

Government Financial Support - Government support as a control variable is focusing on the businesses that able to obtain financial support from government agencies. These entrepreneurs are believed to have used more accounting information in their business and have better financial performance than entrepreneurs who did not seeking government financial support.

1.7 Significance of the Study

Practically, the results of this study intend to provide some insight for entrepreneurs that accounting information may help them to make better decision making for their business expansion as well as sustaining their business in the market. Also, it is expected that the study will instill entrepreneur on the importance of AI in daily operation. Theoretically, this study means to contribute in determining the extent of usage of accounting information in the SMEs as a way to assess their financial management. Similarly it is hoped that this study will add value to accounting practices among SMEs in Malaysia.

1.8 Organization of the Remaining Chapters

Chapter 1 provides a brief introduction about SMEs, the objectives and contribution of this study. There are 5 chapters in this thesis. There are organized as follows.

Chapter 2 reviews the literature of related previous study on topic discussed and describes the theoretical framework and includes the discussion on hypotheses.

Chapter 3 describes the research methodology; research design, data collection and the statistical analysis of the study.

Chapter 4 describes the empirical finding and analysis.

Chapter 5 outlines the major findings, limitation of the study, implication and conclusion that can be derived from the study as well the suggestions for future research.

Chapter 2

LITERATURE REVIEW

2.1 Introduction

This chapter provides a brief introduction to small enterprises (widely known as small business), the definitions, profiles and significant roles of small business in both global and Malaysian economy. Also, this chapter will provide a literature review on the variables, entrepreneur characteristics that include gender of the entrepreneur, education level, access to accounting training and entrepreneurial traits. Organizational characteristic will focus on business age. The control item is the financial government support programs undertaken by the entrepreneur. Accounting information will explain the statutory accounting information, budgetary accounting information and additional accounting information.

2.2 Review of the literature.

2.2.1 *Small Enterprise or Small Business*

2.2.1.1 *Definition and Profile of Small Business*

Small and Medium Enterprises (SMEs) may range from a part-time business with no employees, for example exchanging money or selling handicraft; to a semi-conductor manufacturer employing hundred of people. The “legal” definition of SMEs may vary by country and industry but generally are fewer than 500 employees. These businesses are normally privately owned corporation, partnership or sole proprietorships. However other

methods are also used to classify small and medium enterprise such as annual sales (turnover) asset value or net profit, headcount or balance sheet total and ownership status of a business (<http://www.wikipedia.com> and Holmes & Gibson 2001). SMEs are very common in most of the countries depending on the economic system in operation and most of them in Asian region are very small (Harvie & Lee, 2003). The smallest business; often located in private home is called micro business and normally are family owned business.

Presently, there is no common definition of SMEs in Malaysia. Different agencies define SMEs based on their own criteria and benchmarking used. For standardization, the National SMEs Development Council has, on 9th June 2005, approved the common definitions of SMEs across economic sectors for adoption for all Government Ministries and Agencies involved in SMEs development as well as financial institution to be as **“Number of employees” or “Annual sales turnover”**.

Each economic sector has different benchmark of number of employees as well as their annual sales turnover. For simplicity, below is the summarization of approved definition.

i) Based on number of employees:

Size/ Sector	Primary Agriculture	Manufacturing (including Agro- Based) & MRS	Services Sector (including ICT)
Micro	Less than 5 employees	Less than 5 employees	Less than 5 employees
Small	Between 5 & 19 employees	Between 5 & 50 employees	Between 5 & 19 employees
Medium	Between RM1 million & RM5 million	Between RM10 million & RM25 million	Between RM1 million & RM5 million

Figure 2.1 SMEs definition based on number of employees

ii) Based on annual sales turnover:

Size/ Sector	Primary Agriculture	Manufacturing (including Agro- Based) & MRS	Services Sector (including ICT)
Micro	Less than RM200,000	Less than RM250,000	Less than RM200,000
Small	Between RM200,000 & less than RM1 million	Between RM250,000 & less than RM10 million	Between RM200,000 & less than RM1 million
Medium	Between RM1 million & RM5 million	Between RM10 million & RM25 million	Between RM1 million & RM5 million

Figure 2.2 SMEs definition based on annual sales turnover

Most of the literature review regarding small business is found in Australian context. Holmes and Gibson (2001) has give a definition of small business as

“A business which is independently owned and operated, with close control over operations and decisions held by the owner. Business equity is not publicly traded and business financing is personally guaranteed by the owners. The business will have less than twenty employees.”

Almost all small business operations are centered around family members and their homes. Latest data (1996-1997; Australian small business) showing two-thirds of small businesses are owned by members of the same family and 76 percent operated from home or at home. The vast majority of small businesses (84 percent in 1996-1997) are micro businesses with fewer than five employees. In 1996-97, about 45 percent of small business had no employees at all (Australia Annual Review of Small Business, 1999).

2.2.1.2 The Roles of Small Business

It is well known that small business play an important role within the economy. Apart from the generation of employment, as cited by Holmes and Gibson in Holmes (1991) proposed that small business is a competitive spur to large firm because they are fast and flexible. They are performed as important sub-contract functions and are important import substitution role. Also, some small firms are pioneer in creating new ventures which is an important route for getting new ideas into an economy. Additionally small firm which is normally locally owned, are in a way in which centralizing forces in the distribution of power in society can be counterbalanced.

In the Malaysian context, Abdullah, (2002) has listed the role of small business in Malaysia as giving employment opportunity, contribute to national saving and reduce foreign exchange cost and giving better distributional income for employee. Additionally they are helping in producing and increasing technological and management in foreign and local expertise, improving relationship with big firm and strengthening the basic structure of national industries.

2.2.1.3 Key Internal Weaknesses in Small Business

Collin Barrow in her book "*The Essence of Small Business*" has stated that small business fail because of few reasons. Lack of expertise, no product or marketing strategy, over-optimism about market size, underestimating the start-up time, consequences of early growth, wrong location and problem in selecting and managing people seems to be major problem for entrepreneur. Mistaking cash for profit and no management account had shown that poor financial management can result the entrepreneurs fail to continue

and expanding their business. As small businesses are known for their poor performance on their financial management skills, some are fails because of no management account. This is because most entrepreneurs often see regular accounting as a bureaucratic nonsense carried out for the benefit of the Inland Revenue only. As the result of this, most of them have to end their business by the end of their first year operation (Barrow, 1993).

The study done by Van Auken (1993) indicates that financial distress and failure of the business is the result from poor managerial and planning functions as a first factor. Having adequate skills is critical for the entrepreneur to process the information and making the right decisions for their business. The second factor is from working capital management which includes inadequate working capital decisions and accounting information. They also list several external factors such as "poor relations with vendors," "difficulties in receiving merchandise," "competition from discount stores," "inability to compete in trading area" and "failure to offer saleable merchandise assortments". The overview by Peacock (2000) also agrees that the root cause of failure is management inefficiency and particular inefficient financial management and poor accounting.

Abdullah (2002) in his book "*Industri Kecil di Malaysia*" stated that small industry's major problem is lack of capital and credit. From previous research made, most small scale entrepreneurs identified seeking financial help and credit from financial institution, seems to be their major problem. Most entrepreneurs find it difficult to obtain credit from financial institutions. This is due to lack of collateral or any track record. Even though recently Bank Negara has attempted to address various initiatives to provide loans amongst which is Credit Guarantee Corporation that stands as guarantor to SMEs

lacing collateral and track record, entrepreneur cannot take it for granted as the main issue is the lack of the skills itself. According to Ndubisi and Salman (as cited in Ndubisi, 2006), one reason frequently cited by lenders for the difficulty in providing financing is the reluctant of many SMEs to fully disclose their financial transactions that are linked to lack of transparency and unavailability of audited financial statement. For many SMEs, the major constraint is failure on their part to meet loan requirement of lenders. For example, producing audited financial statement, track record and loan collateral especially at the early stage of development is difficult for SMEs but is the key consideration in the appraisal of loan application by financial institution. Also, many SMEs are reluctant to use commercial banks for payroll management and day-to-day working account. Hence most of these banks do not have enough information relating to cash flow, business performance, credit history and business commitment of the SMEs concerned.

Banks remain to be the primary source of capital and credit for the most businesses including SMEs in many ASEAN countries (Ndubisi & Salman, (as cited in Ndubisi, 2006)). According to World Bank and IMF, the stock outstanding bank loans in Indonesia, Malaysia, Philippines and Thailand was about 92 percent of their combined GDP, compared with about 45 percent in India and Korea which means the proportion of available loan are higher in Indonesia, Malaysia, Philippines and Thailand. According to Bank Negara survey in 2004, the majority of Malaysian SMEs obtained finance from banking institution, followed by their own contribution 32.4 percent while borrowing from family and friends accounts to 11 percent. Currently there are six government financial institutions which include Bank Negara Malaysia, SME Bank, Bank Pertanian