

The Relationship between Management Accounting Practices and Performance of the Small and Medium Enterprises in Libya: A Proposed Conceptual Framework

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Abstract

Economists acknowledge that the small and medium enterprises (SMEs) are one of the major contributors to the social and economic development. These enterprises are the principal driver of economy and growth in the majority of the developing countries. They are the principal absorber of the labor and a true driver of the investment, competition, and economic growth. The SME sector contributes to economic advancement by virtue of its role in generation of wealth; creation of job opportunities, and reduction of poverty. This paper suggests conceptual framework for investigation of the role of the management accounting practices (budgeting, costing, performance evaluation, decision support, and strategic planning) on the levels of performance of the SMEs by using a sample of the manufacturing companies in Libya. Previous studies provide evidence supporting that the management accounting practices (MAPs), which include financial and non-financial information, constitute one of the most important management information systems (MISs) that should be utilized by the SMEs. This study maintains that the MAPs are important for the SMEs in order to survive and continue their businesses.

Keywords: small and medium enterprises, management accounting practices, Libya

1. Introduction

Recently, numerous discussions arose about the management accounting practices (MAPs), especially with respect to their important role in the planning and control of the activities of the SMEs. Much like the large enterprises, the SMEs need to employ management accounting information and practices (MAI and MAPs, respectively) so as to improve their levels of performance, manage with the lack of resources, and boost the values of these enterprises (Nandan, 2010). In the business markets, the SMEs struggle for the survival and growth. There are numerous reasons for discontinuity of the business among the SMEs in addition to the pressure posed on them by the rapidly-changing market conditions. These reasons include lack of sufficient working capital, poor managerial skills, and insufficient employment of the essential business and management practices. Employment of MAPs, which can provide the management with crucial information, is vital for ensuring the efficiency and effectiveness of the business (Ahmad, 2012).

The MAI has an important role in the planning and control of the activities of the SMEs. Much like the large enterprises, the SMEs need to employ the MAI and MAPs in order to improve their levels of performance, manage with the lack of resources, and boost their market values (Nandan, 2010), even though the SMEs can have some limitations to full utilization of the MAPs because of their relatively small sizes and limited resources. As well, the SMEs experience the same uncertainties and complexities which the large enterprises experience, but are more prone to failure. In consequence, the need for accurate and reliable strategic MAI that is largely provided by management accounting systems (MASSs) is equally important for the SMEs. In this respect, the MAPs have a potentially important positive effect on the SMEs (Ahmad, 2014).

Availability of non-financial and financial information that is provided by MAPs enables the enterprises to effectively face the competition in the market, cope with change, survive, and improve their performance (Mia and Clarke, 1999; Reid and Smith, 2002). Albeit the good MAPs may not by themselves warrant success, their absence or poor implementation may reduce the competitive ability of the enterprise significantly (Folk et al., 2002). Hence, it is important to support the SMEs by advising their managers and owners to adopt and implement MAPs (Ahmad, 2012).

This paper proposes conceptual framework for investigation of the relationships between performance of enterprise and five MAPs: budgeting, costing, management accounting, strategic management accounting (SMA), decision support, and performance evaluation. The rest of this paper is organized as follows: the second section draws the background of the study; the third section presents a review of the relevant, recent literature; the fourth section discusses the conceptual framework of the study and illustrates hypothesis development; then, the fifth section summarizes the study and highlights its major conclusions.

2. Background of the Study

Libya lies on strategic geopolitical location that merges the Arab, Islamic, African, and European cultures. The identity of Libya has been affected by the relations of Libya with these cultures, and the various facets of the

collective identity of Libya have emerged at different times through the history of the country (Obeidi, 2001; Ahmad and Gao, 2004; Ritchie and Khorwatt, 2007; Ahmida, 2012).

The focus of the Libyan state has been on securing the country and not as much on creation of an encouraging business environment, which should actually be the next major concern (Porter and Yergin, 2006). In other respects, development and growth of the private sector has been more problematic than expected, mainly due to the poor infrastructure, an underdeveloped financial system, limited supply of educated workers and employees, and ineffective public administrations. Within this respect, one of the principal problems which the private companies face is the uncertainty resulting from different and shifting interpretations of the related laws, particularly the legislation on taxation, and the lack of transparent and rapid mechanisms for solving the commercial disputes (EN, 2013). These factors keep the foreign ventures out of, and away from, Libya. Thereupon, the domestic conditions in Libya prevent the Libyan business from access to technology, resources, and experts (Porter & Yergin, 2006).

In Libya, there is a large number of small-, and medium-sized enterprises (SMEs). Albeit the exact size of this sector is still unknown. However, according to the Libyan tax authorities, there are 180,000 officially-registered private enterprises. Yet, senior Libyan government officials believe that there are many productive enterprises in the informal sector, which is a quite risky and inefficient sector and which faces serious difficulties in achieving scale. Most of the small enterprises are running their businesses outside of the formal market so as to avoid the taxes and because of regulatory and other fiscal considerations (Porter & Yergin, 2006). In the time being, the SME sector in Libya is mainly engaged in the production of wood and food products, and metals for the construction industry. Some small firms are also engaged in production of bricks, ceramic, and clothing.

3. Literature Review

The MAPs represent a set of the most important financial practices within organizations. The goal of the management accounting is to present non-financial and financial information that are helpful in the internal planning for the managers, owners, investors, and employees (Zoubi, 2011).

The SMEs sector contributes to the economic advancement through poverty reduction, wealth generation, and provision of job opportunities (Kithae, Gakure, & Munyao, 2012). These enterprises are an essential component of the economic fabric in most of the developing countries. They play a highly important role in furthering innovation, growth, and prosperity (Dalberg, 2011). For example, they contribute about 70.0% of the GDP of the world economy. However, even though 96.0% of the enterprises in Libya are actually SMEs, their contribution to the national GDP is only 4.0% (Suliman, 2011).

In an investigation of implementation of MAPs in SMEs, Ahmad (2013) found that the MAPs adopted by the SMEs in Malaysia were mainly the traditional MAPs that are broadly used by SMEs like traditional costing, conventional budgeting, and the financial performance measures. In addition, the results of this study showed that a large number of the SMEs have adopted one or more of the non-financial and financial measures. However, in these enterprises reliance was more on financial than non-financial measures. Further, the SMEs employing non-financial performance measures are more internal process-focused than employee-, or customer-focused.

Ahmad & Leftesi (2014) studied the level of sophistication of the MAPs in Libyan manufacturing companies and found that these companies depend heavily on the traditional management accounting techniques and that the level of adoption of advanced, or recently-developed, tools was fairly slow and low, however, much comparable with the levels reported for other developing countries. Analysis of the data of this study further indicated that implementation of MAPs in Libya was somewhere between stages one and two according to the IFAC-based model.

Nimtrakoon (2009) studied the MAPs applied in Thailand. The study results revealed popularity of the traditional MAPs, disappointing rates of adoption of the contemporary MAPs, and a relatively low level of perceived benefit of these MAPs. A year later, Nimtrakoon (2010) reported that the characteristics of the enterprises, represented by exogenous strategy and endogenous variables, have effects on design of the MASs in the organizations. Thereupon, this researcher recommended the prospector enterprises and those suffering from high levels of environmental uncertainty to consider an increased use of the contemporary MAPs.

The next section introduces the research model and illustrates development of the research hypotheses. As well, in this section, the five major MAPs that affect performance of the SME's are discussed. These practices are performance evaluation, budgeting, cost, SMA, and decision support.

4. The Research Model and Hypothesis Development

The MAPs and their relationships with the levels of performance of the SMEs are integrated into one model which draws the conceptual framework of this study as illustrated in Figure 1. In this model, the MAPs are the independent variables while performance of enterprise is the dependent variable. Thus, this study attempted to bridge a gap in the literature by providing basis for tracing the impacts of the MAPs on performance of the SMEs. The research hypotheses associated with this conceptual model are formulated and discussed in sub-

sections 4.1-4.4.

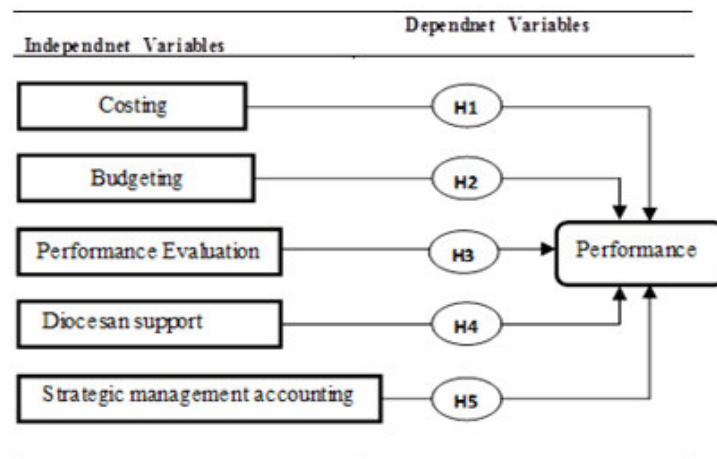


Figure (1) Research Model: Relationships between Performance of SMEs and MAP

4-1 Costing System

Recently, the importance of the cost and management accounting practices has grown more than ever before. Reasons for this fundamentally include that (i) the global and domestic competitions are getting more and more severe by effect of globalization; (ii) the profit margins are declining; (iii) prices of the inputs are increasing because of the tightening energy sources; and (iv) the economic crises. Hence, the firms operating in developing countries have started implementing the cost and management accounting practices, which were adopted first by firms operating in developed countries. In parallel with these developments, the research studies which were initially implemented in developed countries have been followed by comparable studies implemented in developing countries. However, many researchers (e.g., Lin and Yu (2002)) maintain that application of management accounting in the less developed countries remains non-satisfactory and that studies in this field are scarce in the literature. In harmony with this, review of the literature confirms that the cost and management accounting practices influence the levels of performance of the SMEs.

A bulky volume of research on the MAPs and their influence on the levels of performance of the SMEs has been performed, especially after the 1990s (e.g., Chenhall & Langfield-Smith (1998) and Joshi (2001)). According to Ahmad (2012), these studies were largely motivated by the proclamations about irrelevance of the management accounting for the current managerial needs, particularly in modern manufacturing, and by the claims that there is gap between the management accounting theory, as described in the textbooks, and the MAPs (Drury, Braund, Osborne, & Tayles, 1993).

Abdel-Kader and Luther (2006) argued that for the short-term or the regular decisions, the management accountant may use the product profitability analysis, the cost-volume-profit (CVP) analysis, stock control models, and the customer profitability analysis. For the long-term capital investment decisions, the management accountant can generate and review the payback periods, accounting rates of returns, and complex signals on the basis of the discounted cash flow. The payback period approach to evaluation of the investment is common in many countries (e.g., Shields et al. (1991), Yoshikawa (1994), Lazaridis (2004), Abdel-Kader & Luther (2006), and Hermes et al. (2007)).

H1: *The costing system has a significant, positive influence on performance of small and medium enterprises*

4-2 Budgeting System

Review of the literature reveals that the principal functions of budgeting are controlling the costs; and planning the future financial position, cash flows, day to day operations, and performance. Intensive use of budgeting for controlling the costs and for planning have been highlighted by many researchers (e.g., Lyne (1988), Chenhall & Langfield-Smith (1998), Joshi (2001), Szychta (2002), Fruitticher, Laster, & Yakhou (2004), Sulaiman et al. (2004), Abdel-Kader & Luther (2006), and Pavlatos, Paggios (2009). In almost all companies, the budgeting is thought of as an important control system (Hansen and Van der Stede, 2004).

Comparisons between the standard costing and the budgeting practices followed in the UK and New Zealand uncovered high degree of consistency in the two countries. De Zoysa and Herath (2007) found that the standard costing procedures are still being applied by a large number of the enterprises, both in developed and developing countries, which is a finding that agrees with the results obtained by Guilding et al. (1998). This study suggests that importance of the standard costing has not recessed substantially in spite of the technological changes. In this context, Sulaiman et al. (2005) reported that the standard costing is still applied by the majority

of the enterprises in Malaysia. Therefore, the Malaysian firms (both the local and the Japanese companies) support that the basic principles of the standard costing remain sound. Joshi et al. (2003) mentioned that most of the sample companies they surveyed in Bahrain used to prepare long-term operating budgets and plans.

In spite of its widespread application, the budgeting has been criticized over the years on several grounds. Hansen et al. (2003) stated that practitioners argue that the budgets hinder allocation of the organizational resources to their optimum uses and encourage the shortsighted decision making and other improper budget games. They ascribed these problems partly to the top-down, 'command and control' direction of the traditional budgeting as enclosed in the annual budget planning and the performance evaluation processes (Bourne, 2004). A new approach; the Beyond Budgeting Round Table (BBRT) approach, was developed in order to solve the problems associated with the traditional budgeting. This approach aims at managing enterprise without traditional budgets.

Originally, the BBRT approach was developed so as to investigate the budgeting problems and find out why it has grown into such a major obstacle to improvement of the organizational performance, as well as to affect positive change (CAM-I11, 2002). Cassell (2003) provided evidence on that the organizations of the private sector which have adopted the BBRT approach have performed better than their peers who were still following the conventional budgeting approach.

However, in spite of the weaknesses in the traditional budgeting method, most of the researchers have found that implementation of the traditional budgeting still prevails. For instance, Hansen et al. (2003) pointed out that the vast majority of the U.S enterprises retain some formal budgeting process in spite of the long list of the associated problems and the many calls for improving the budgeting process. Likewise, Dugdale and Lyne (2004) found that budgeting was still alive by that time and well. They reached to the conclusion that while the traditional budgeting is more likely to be integrated with increases in the non-financial indicators of performance, its demise appears to be unlikely.

H2: The budgeting system has a significant, positive impact on performance of the small and medium enterprises.

4-3 Performance Evaluation

Emmanuel et al. (1990) underscored that performance evaluation is important for the management accounting. It provides information for the managers to further support achievement of the strategic objectives of their organizations. Hall (2008) and Meantime, Jusoh and Parnell (2008) maintained that the organizations have sought in recent years to develop more comprehensive performance measurement systems (PMSs) in order to provide the employees and the managers with information to help in management of their operations.

These researchers added that the comprehensive PMSs encircle a varied set of the performance measures, as well as performance measures that are connected with the strategy of the organization. Hall (2008) listed common techniques for delivering a broader set of performance measures, which include the performance hierarchies (Lynch and Cross, 1991), the balanced scorecard (Kaplan and Norton, 1996), and the tableau de board (Epstein and Manzoni, 1998). However, selection of the measures to guide and evaluate performance of the business units is one of the most critical challenges which the organizations face.

The Chartered Institute of Management Accountants (CIMA) (2002) outlined the following frameworks for measurement and management of performance: the ABC and activity-based management; the value-based management (VBM); the excellence model of the European Foundation for Quality Management (EFQM); benchmarking; the balanced scorecard; Six Sigma; and the strategic enterprise management (SEM). However, the literature (e.g., Gomes et al. (2004) and Demirbag et al. (2006)) brings to surface that both non-financial and financial measures are in general used for evaluation of performance.

Nonetheless, newer non-financial measures of performance have been more broadly employed by the organizations over the time (Drury and Tayles, 1993; Gomes et al., 2004; Ismail, 2007). Banker et al. (2000) explained that the main reasons suggested for use of the non-financial performance measures are that these measures are (i) valuable in evaluating the managerial performance and motivating it, and (ii) better indicators of the future financial performance than the accounting measures. So, this development occurred in response to the substantial criticism that the excessive emphasis on, and concern about, targeting of the financial indicators may give rise to short-run thinking (Gomes et al., 2004). On the other hand, within the family of the non-financial performance measures, the measures related to the customers have a higher level of adoption than the rest non-financial measures.

H3: Performance evaluation has a significant, positive influence on performance of the small and medium enterprises.

4.4 Decision Support

Wu et al. (2007) maintain that effective decision making is the most important principal factor in the rapidly-changing competitive market environment of today. Decision support analysis may be categorized into long-term and short-term analysis. Abdel-Kader and Luther (2006) clarified that for the short-term or regular decisions the

management accountants can apply product profitability analysis, the CVP analysis, stock control models, and the customer profitability analysis. In the case of the long-term capital investment decisions, the management accountants can generate and review the accounting rates of return and the payback periods besides the complex signals on the basis of the discounted cash flow.

The capital-budgeting methods accommodate both the discounted and the non-discounted approaches. Klammer et al. (1991) explained that superiority of the net present value (NPV) and the internal rate of return (IRR) analyses have been demonstrated repeatedly under certainty conditions. However, under the conditions of uncertainty, the techniques most commonly employed are increased required rates of return, sensitivity analysis, Monte Carlo computer-based simulations, and the game theory. The payback period approach to investment evaluation is common in most of the countries (e.g., Shields et al (1991), Yoshikawa (1994), Lazaridis (2004), Abdel-Kader and Luther (2006), and Hermes et al. (2007)). A level of adoption corresponding to a percentage of 41.0% was reported in the U.K by Abdel-Kader and Luther (2006), which is a much lower percentage than the corresponding percentage (84.0%) reported for each of China (Hermes et al., 2007) and Japan (Shields et al., 1991). This level of acceptance may be attributed to simplicity of this method which makes evaluation of the projects easier. To the contrary, techniques like the IRR and the NPV have been adopted to lower levels, e.g., 19.0% in the UK (Abdel-Kader and Luther, 2006) and about 15.0% in Japan (Shields et al., 1991). However, Hermes et al. (2007) found that the NPV method is the most common method (89.0%) in the Dutch firms which they surveyed.

The methods of dealing with the uncertainty have too been researched (e.g., Shields et al. (1991), Lazaridis (2004), Abdel-Kader and Luther (2006)). In this respect, Abdel-Kader and Luther (2006) indicated that the U.K firms applied 'What if analysis' (22.0%) and computer simulation (6.0%), and. Shields et al. (1991) found that only 19.0% of the Japanese companies were considering risks explicitly. Contrariwise, higher rates, ranging from 48.0% to 93.0% were reported in the U.S.A. Break-even analysis is another decision support method that experienced relatively moderate level of adoption. For instance, the reported levels of its adoption corresponded to the percentages of 38.0% in the U.K (Abdel-Kader and Luther 2006) and 47.0% in Poland (Szychta, 2002). To the contrary, Chenhall and Langfield-Smith (1998) reported a level of adoption corresponding to the percentage of 86% in Australia. Product profitability analysis has been adopted to a high level, both in developing and developed countries. As an example, Abdel-Kader and Luther (2006) reported its use by 69.0% of the respondents in their study.

H4: Decision support has a significant, positive impact on performance of the small and medium enterprises.

4.5 Strategic Management Accounting (SMA)

A final set of the MAPs is contained in the SMA. Bromwich (1990) defined the SMA as provision and analysis of the financial information about the product markets of the enterprise, the costs of the competitors, cost structures, and monitoring of the strategies of the enterprise as well as those of its competitors in the markets over a number of time periods. Tayles and Drury (1994) argued that the conventional management accounting does not deliver the financial information that is required for monitoring the existing strategies or supporting strategy formulation. The SMA aims at remedying this situation by providing financial analysis so as to support creation of successful competitive advantages (Tayles and Drury, 1994). Lord (1996) summarized the main themes presented in the previous literature on SMA and proposed three important actions: collection of information about the competitors, exploitation of the opportunities of cost reduction, and matching the accounting emphasis with strategic position.

In other respects, Guilding et al. (2000) spotlighted 12 accounting techniques of strategic management under three categories: brand value accounting, pricing attribute costing and strategic costing, and competitor accounting. Somewhat recently, Cadez and Guilding (2008) applied five processes of SMA: (1) planning, control, and performance measurement; (2) costing; (3) customer accounting; (4) competitor accounting; and (5) strategic decision making. Even though there is strong academic support for the SMA concept, Guilding et al. (2000) underlined that there seems to be negligible use of the SMA term in the organizations and that the practicing accountants have limited appreciation of what this term means. Smith (2007) reviewed previous studies conducted in Australia and reached to the conclusion that the SMA techniques have not been widely understood, or adopted, or used. However, the SMA has affected the language and thinking of the business besides the way how the companies implement the various business processes.

Most of the previous studies reported low to moderate levels of adoption of the SMA practices. As an example, target costing is one of most well-established approaches in SMA. Nevertheless, it was only applied by 24.0% of the companies in the U.K (Abdel-Kader and Luther, 2006). As regards India and Australia, the reported levels of adoption corresponded to the percentages of 35.0% (Joshi, 2001) and 38.0% (Chenhall and Langfield-Smith, 1998), respectively. More generally, Abdel-Kader and Luther (2006) mentioned that even though the competitive position analysis and customer profitability analysis were applied by up to 51.0% of the respondents in their study, other SMA methods like the value chain analysis, shareholder value analysis, and

industry analysis were applied by less than 20.0% of the respondents. The survey results obtained from India (Joshi, 2001) and Australia (Chenhall and Langfield-Smith, 1998) support low levels of adoption of the value chain analysis. Moreover, Guilding et al. (2000) explored application of the techniques of SMA in New Zealand, the UK, and the U.S.A and found that strategic pricing and competitor accounting were the most commonly applied techniques.

H5: *The strategic management accounting has significant, positive influence on performance of the small and medium enterprises.*

5. Summary and Conclusions

Management accounting plays many important roles in the process of management in the organizations. Decisions making, planning, control, and performance evaluation have been identified as the main roles of management accounting. In addition, the traditional MAPs are used widely by the organizations in spite of criticisms of their lack of relevance, and use of newly-developed MAPs is growing, however, the levels of their adoption and use are still low in the majority of the developing and developed countries.

On the other hand, this review of the literature identified a wide gap in the literature relating to use of the MAPs by the SMEs in the developing countries, particularly Libya. The literature review confirmed that the management accounting plays highly-important roles in the management process in the organizations. Control, planning, decisions making, and performance evaluation have been identified as four of the major roles of management accounting in the organizations. Moreover, the management accounting is conceived to be involved in the formulation and implementation of the strategies of the enterprises and in creation of added values for them.

Additionally, this review of the related literature indicates that there is limited research into the roles of the management accounting in management of the SMEs, both in the developing and the developed countries. Some researchers indicated that the lack of application of the MAPs in Libya can be due to lack of skill among the Libyan managers in application of MAPs. Hence, this study discussed several practices of management accounting.

In specific, this paper studied the effects of the MAPs on the performance of the SMEs in Libya from the own perspective of these enterprises. Five elements of management accounting are proposed: budgeting, costing, performance evaluation, SMA, and decision support. Consequently, five hypotheses were developed. So as to test these hypotheses, a survey research will be conducted.

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