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Exploring the influence of profitability analysis on SME financing: A conceptual view

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Abstract

By allocating earnings and expenditures to each client independently, customer profitability analysis is a management accounting and credit underwriting tool that enables businesses and lenders to assess the profitability of individual customers or segments of customers. Small and medium-sized businesses (SMEs) constitute the backbone of most economies and a key driver of economic expansion. This conceptual study surveys the literature on the subject in order to make assumptions that might be tested in subsequent research on the role of cost-benefit analysis in raising corporate performance. This is accomplished by referencing the viewpoints on financing small and medium-sized businesses as well as the fundamentals of strategic management accounting. The financial services sector, as well as the informal and formal sectors of the economy in every nation, would benefit greatly from an investigation into this issue. The originality of this conceptual study is in its contribution to the advancement of conceptual, methodological, and theoretical justification for the effects of profitability analysis funding of small and medium-sized enterprises. This will support the discussion in the present literature.

Keywords: Profitability Analysis; Management Accounting; SME Financing; Business Environment; Strategic Management

1. Introduction

In both developing and developed economies, small and medium-sized businesses (SMEs) constitute an important source of employment for many people. According to the 2016 World Trade Report, SMEs account for 90% of the global economy, generate 60% to 70% of employment, and contribute 55% to GDP, underscoring their significance as current and future catalysts for the growth and development of the economy. Limited access to financing is one of the major challenges faced by SMEs. To effectively encourage financial access for SMEs, governments and financial institutions must comprehend how SMEs obtain financing (Rao et al., 2021). For many SMEs and entrepreneurs, bank financing is the most frequent form of external funding because they frequently rely largely on conventional debt to meet their start-up, cash flow, and investment demands. This can be adequately achieved by leveraging on the right leadership styles (Masevo & Aigbogun, 2022) ion order to navigate the chaotic business climate that has come to typify current global realities (Aigbogun et al., 2014; 2018). Although it is frequently employed by small firms, traditional bank financing presents difficulties for SMEs, particularly for younger, more inventive, and rapidly expanding organisations with a greater risk-return profile (Cusmano, 2015). Additionally, capital gaps exist for businesses making significant changes to their operations, such as changing ownership or control, as well as for SMEs looking to deleverage and enhance their capital structures. Due to the fact that many businesses had to expand their use of leverage in order to survive the most recent economic and financial crisis, the long-standing need to improve capital structures and reduce reliance on borrowing has become more critical. In fact, policy solutions to the crisis, which tended to focus on mechanisms that enabled enterprises to raise their debt, may have made the issue of SME over-leveraging worse. In parallel, banks in numerous nations have been reducing their balance sheets to conform to stricter prudential regulations (Cusmano, 2015).

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There is widespread worry that credit restrictions will simply become the new reality for SMEs and business owners, despite the fact that bank funding will continue to be essential for the SME sector. In order to enable SMEs and entrepreneurs to continue playing their role in investment, growth, innovation, and employment, it is vital to expand the range of financing instruments accessible to them.

A process of analysis called a "profitability analysis" aims to shed light on the organization's numerous revenue streams. It is employed to support enterprise resource planning and aids in helping leaders identify strategies to maximise revenue. By allocating earnings and expenditures to each client independently, profitability analysis is a management accounting and credit underwriting method that enables businesses and lenders to assess the profitability of each customer or segment of customers. Profitability analysis enables administrators to forecast a proposal's profitability or improve the profitability of an ongoing project. An analysis of profitability can forecast sales and profit potential for particular market segments, such as client age groups, geographic areas, or product kinds. This is where this study draws its relevance. The main purpose of this study is to explore, conceptually, the possibility of advancing SME financing through the management accounting instrument of profitability analysis. The findings would beneficial in furtherance of strategic management accounting and its instrumentalization in SME financing decision making.

2. Literature Review

2.1. SME Financing Sources

Sources of finance for SMEs from a supply standpoint, bank financing is the subject of SME finance that has received the most research. Banks are the most suitable external source of finance, according to existing literature, for the SME sector in both developed and developing nations. Keasey and McGuinness (1990) note that despite its high expenses, bank funding results in a greater rate of return for SMEs. According to Vera and Onji (2010), bank financing can help SMEs perform better compared to alternative forms of funding because banks monitor SMEs' finances and thus help keep them in check so they manage their resources more wisely and effectively.

SME debt financing from banks and other financial institutions increases their leverage. According to the literature, this is impacted by market consolidation (Vera & Onji, 2010), managerial ownership (Niskanen & Niskanen, 2010), certification effect (Li et al., 2020), liquidation policy (Huyghebaert et al., 2007), managerial ownership (Niskanen & Niskanen, 2010), and, more recently, the financial crisis (Cainelli et al., 2020).

2.2. Conceptualizing Management Accounting and Profitability Analysis

The advancement of management accounting places a strong emphasis on both the internal and external sides of business operations. The function that management accounting plays in measuring performance-related factors contributes to its significance (Fowzia, 2011). Both Uyar (2010) and Rehman (2011) found that managers of Turkish manufacturing businesses still view the use of traditional accounting tools as crucial in their studies of a sample of Pakistani manufacturing enterprises. The majority of definitions of management accounting have a heavy emphasis on business tactics used to compete, like Activity Based Costing, Budgetary Controls, and Cost Volume Profit Analysis (Cadez & Guilding 2008).

While Bhimani & Bromwich (2010) discovered in their research that management accounting solutions are widely used within organisations. Budgetary management, activity-based costing, and cost volume profit analysis were all found to be crucial in managing risk, according to Siti, Abdul, and Wan (2011).

As a result, management accounting collects, analyses, and publishes financial and non-financial data to assist managers in reaching an organization's objectives. Managers can do this because they use management accounting data to determine, communicate, and carry out strategy. To coordinate choices about product design, production, and marketing, they also use management accounting data. Internal reporting is the main emphasis of management accounting (Horngren, Foster & Datar 2007).

Profitability analysis is now given significant weight by businesses and is seen as one of the most crucial management accounting procedures, according to recent study on these activities. However, there hasn't been much recent empirical study on the nature and function of profitability analysis in businesses (Drury & Tayles, 2006).

3. Methodology

In order to synthesise pertinent research on SME financing, strategic management accounting, and profitability analysis, this study uses a conceptual method. A protocol was devised before to the search, and the results of the review were transparently published with it. The following conclusions were drawn from the review of pertinent literature: The distribution of methodological design in the area is based on four groups, according to the methodological design of the SME finance research. Real-time data investigations fall under the first type of empirical research. Modeling and simulation research, which includes studies utilising analytics, mathematical modelling, and simulations, is the second category. Studies that don't use real-time data fall under the third category of conceptual research, which includes those. Review research, the final and fourth type, includes studies that evaluate earlier research.

4. Discussion

Although alternative forms of debt have been used sparingly by the SME sector, even in the larger size segment that would be suitable for structured finance and could profit from access to capital markets, to invest, and seize growth opportunities, asset-based finance is a widely used tool in the SME financing landscape. Alternative debt actually differs from standard lending in that capital market investors, not banks, supply financing for SMEs. The creation of a corporate bond market for SMEs, primarily mid-caps, has been encouraged by policymakers who have paid particular attention to investor protection and transparency regulations that encourage more participation and liquidity. The inability to acquire and utilise financial resources is known as a financing constraint (Rao et al., 2008). Poor accounting, financial, and regulatory systems (Beck & Demirguc-Kunt, 2006), competition, policies and practises that affect the supply of finance, such as interest rates (Foltz, 2004), and a lack of awareness and knowledge of the available sources of and how to access finance (Cook & Nixson, 2000), among other factors, are the causes of financing constraints. These factors can increase credit risk and transaction costs for SMEs.

5. Conclusion

High and consistent profits from a well-run business may lead to more employment opportunities and personal income. A company's financial success will also translate into higher staff wages, better production facilities, and better products for its clients.

This theoretically oriented review's key advantage is that it offers organised data on previously published research in terms of the methodological approaches taken, the variables examined, and the results attained.

This study has identified both conventional and cutting-edge financial resources that SMEs can utilise in addition to giving remedies for the gaps that are now present. As time and technology progress, new forms of finance are projected to appear.

The logic of the current study suggests that, for any firm trying to maximise the expected economic value of a strategic business intervention, cost-benefit analysis may be the optimal course of action. But even in these conditions, some more value-laden presumptions and decisions must be made. One difficulty is striking a balance between current costs and future returns. The results of the analysis could be significantly impacted by the choice of discount rate. After the cost-benefit analysis is complete, alternative selection criteria may be used. As long as the advantages exceed the drawbacks, all solutions might occasionally be considered acceptable. However, one can also choose the option with the highest percentage of net benefits or the option with the highest net benefits overall.

Suggestion for Future Research Agenda

The results of the current study provide thorough understandings of the funding requirements of SMEs for academics, professionals, policymakers, and other stakeholders at large.

This study acknowledges that the majority of research on SME finance uses archived data and empirical techniques for further study. Even if these methodological decisions are sound, it is advised that future study investigates different research designs and data gathering and analysis methodologies to foster diversity in research evidence. Case studies, experiments, and field studies are so strongly recommended for studies.

Testing the zero order relationships provided in the four research hypotheses posited in this work will be a worthwhile future research priority. Furthermore, additional research incorporating strategic management accounting methodologies and business case study could be done in order to measure the performance outcome of company implementation intervention. Future studies may also consider enhancements in talent retention, employee involvement in decision-making, employee satisfaction, and many other non-financial company performance outcomes.

Compliance with ethical standards

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