

What are the risks facing SMEs in a recovering economy?

It is widely recognised that SMEs are playing an ever increasing role in the changing landscape of the economy of European countries measured in output and employment (EC, 2005). But any analysis of this sector of the economy must consider the needs and dependencies of the various categories of SMEs within the economy, particularly measured by their size. A common definition of SME is that adopted and sourced by the European Commission which is defined by three metrics: employment, total balance sheet value and total turnover. Taking, for convenience, just one of the metrics the number employed, the definitions range from: micro entities 0-9 employees; small entities 10-49 employees and medium entities 50-250 employees. This definition indirectly acknowledges that the nature and needs of SMEs employing, for example, 1 employee as compared to 250 employees will greatly differ (EC 2005). Not surprisingly the evidence suggests that the risks these business entities face will be an important influence in differentiation in terms of their size.

If we now turn to the distribution of SMEs under their defining categories some interesting patterns emerge in terms of their contribution to the EU economy from an employment perspective. The Table below, which also shows the number of business entities as a percentage of the total population and the percentage that each category employs as a total of the total employed in the European Union:

Size of Enterprise	Percentage (%) of total employment	Percentage % of total business entities
Micro	29.6%	91.8%
Small	20.8%	6.9%
Medium	16.8%	1.09%
Large	31.8%	0.22%

In examining micro entities in the EU, a little further, the average number employees working in a micro enterprise is 2.1 and a large proportion of these micro enterprises are one person enterprises (self-employed). To further illustrate the significance of self-employed enterprises, in the UK around 3.7 million enterprises out of a total of 4.8 million are self-employed; that is two thirds of the total enterprises.

The SME business stock, in general, has come out of the recession looking much healthier than expected. During the recession, in a number of EU economies, cautiously SMEs held significantly higher deposits of cash with their banks than ever before. This can be interpreted as being a reaction to low demand in the economy which not surprisingly resulted in businesses being unwilling to invest into inventories and new assets. Following this cautious strategy a number of observers, at the start of the recovery, are suggesting that SMEs will continue to be guarded whilst optimistic. What is now interesting is how these enterprises will behave in the economic recovery and what are the risks to their sustainability?

The analysis and commentary that follows focuses on the smaller business entities within the categorisation of SMEs due to their significant contribution to the economy and because less attention is generally given to them as compared to their larger counterparts. Two issues of importance will be addressed which considers the risk to small businesses in their development in a recovering economy.

It is the nature of small firms that their owners lack or have limited capacity in terms of knowledge and skills, consequently they would therefore benefit from seeking support externally. To a great extent the level of their business activity is contingent upon accessing external sources of information and advice. Research in the UK reveals that a considerable proportion of the business failures among small businesses are caused by a lack of business knowledge and management skills (Beresford and Saunders, 2005). Survival rates are enhanced by those businesses which effectively use external advice and networks. This has been highlighted especially in the case of small businesses seeking to grow in an emergent economy which we are now experiencing. The need for advice gains increased relevance, for example, when owner(s) of a small firm decide to undertake international business

activities (Gooderham et al. 2004; EC 2010). The lack of knowledge related to foreign markets has been identified as a major risk and a barrier to small firms trading overseas (Loane and Bell, 2006).

The evidence points to accounting practices being the most commonly used source of advice by SMEs (Gooderham et al., 2004; Blackburn and Jarvis, 2010; Bennett and Robson, 1999). They play an important role in advising decision-makers in SMEs, particularly in areas where owner managers of small firms lack competences or when strategic changes in the firm are introduced due to, for example, changes in their external environment through the introduction of new regulation or changes in competition in the market place (Jarvis et al., 2014). It is generally believed that the majority of accountants with whom these smaller firms collaborate are small medium practices of accountants (SMPs). SMPs frequently provide their smaller business clients with guidance that goes beyond their core area of expertise, such as business advisory services on international activities and advice on human resources and employment law (Jarvis and Rigby, 2012).

It begs the question why are SMPs at the forefront of giving critical advice to owner managers of smaller entities? The small business research literature points to trust being the critical issue in the development of advisory services between SMPs and their small business clients (Schizas et al, 2012). Trust is initially derived from SMPs membership in a government regulated profession and further developed by the on-going relationship between the small business owner manager and the SMP (Jarvis and Rigby, 2012). The demand for business advisory services often appears to be triggered by owner manager's perception of their accountant as a personal friend or confidant.

The evidence from research also indicates that the motivation for SMPs to provide business advisory services outside their core business activities is primarily two fold. Firstly, it is demand driven, being a response to their customers' requirements, as illustrated in the following quote given by a partner of a small accounting practice who provides internalisation advice to his clients:

„Providing internationalisation advisory services is a competitive necessity. If we didn't we wouldn't have our clients. They'd turn round and they'd go somewhere else“.

Secondly, some partners in accounting practices are motivated to move beyond their traditional accounting services to acting as business advisors. This sets them

apart from their competitors and ultimately provides them with a competitive advantage as illustrated by the following quote made by another partner whose practice has developed expertise in advising on international issues:

„...and most of our clients come to us because we have got international expertise ...So we don't look at ourselves as accountants, we look at ourselves as business advisors“.

In a recovering economy owner managers of smaller business entities have the opportunity to develop and grow. To ensure they are not over exposing themselves to risk it is critical that they seek support from advisers as they do not always have all the necessary knowledge and skills to meet all the questions they confront. The first call for owner managers should be their external practicing accountant. If accountants cannot source the required knowledge and skills they are likely through their networks to provide the advice and help needed (Jarvis et al. 2014).

An important notable feature of the recovery is the lack of availability of bank credit to SMEs, particularly the smaller ones. It has been reported that this is due indirectly to capital requirements imposed on the banks by the regulators and more directly the perceived risks of investing in this sector. The lack of credit can have a number of negative consequences, including, the inability to take up the increased demand, the possibility of overtrading due to the lack of capital and debtors extending trade credit by utilising late payment as a source of finance. Such outcomes will clearly have a negative effect on the economy and the creation of a trading environment that is not sympathetic to these small business entities. To manage these circumstances whilst taking advantage of the up lift in the economy the small business owner must carefully manage cash flow. We all recognise failure not to do so will end up in insolvency. The majority of those businesses that exit through both creditors and their own elected liquidation are due to poor cash flow management. Many of these small businesses could have survived if better managed. The active partnership between the small business owner and external finance specialist advisers can be of a critical influence addressing this issue.

Over recent years we have seen the introduction of alternative sources of finance, sometimes described in the market place as innovative finance products. These sources of finance are seen as alternative to traditional bank loans and overdrafts. Crowd Funding is one of the more common and growing sources of finance. Accord-

ing to European Commission data, in 2012 crowdfunding in Europe saw a 65% growth compared to 2011 and reached 735 million euros and is predicted to be around 1 billion euros in 2013. Crowdfunding is an on-line source of finance as is the case with most of these alternative sources of finance. Online trading is not new to many small business owners. 36% of the Federation of Small Business (FSB) members in the UK traded online in 2012 and obtained finance on-line, therefore owner managers of small businesses are likely to feel relatively comfortable raising finance through this approach.

Crowdfunding can take several forms one of which is lending and raising equity. The benefits and risks of this form of alternative funding are not so easy to be identified at this early stage of its life. However, the main benefits to small business entities are the industry's flexibility and the evidence would suggest ease of access. In particular, the perceived bureaucracy as a hindrance in traditional banking and is to some extent swept away. Of the risks and challenges reported perhaps the most

important is the lack of understanding of the risks by users and risk of detrimental consequences of a scandal. It is likely however, that regulatory authorities will start imposing regulation on the industry. We can hope that such regulation is protective whilst being sympathetic to a potential important source of finance for the small business.

In this article I have focused on two important issues of advisers and a growing source of finance. This first helps the small business owners to negotiate their way in a busy economic recovery period whilst the second issue focuses on a relatively new and important source of finance where the risks are difficult to identify.

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