

Accountants as Catalysts for Growth ("A4G"): Preliminary assessment of SME financial management in Albania and Serbia



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Introduction

» It is not just about financial reporting for SMEs! This agenda is more than regulating SME financial statements, it is about SME access to human capital and technology to improve financial management practices.





Introduction

- » Financial management and financial governance is critical to success in the SME sector
- » SME access to finance is often focused on the supply side, think of this work as relating to the demand side
- » What is A4G and why is it on CFRR agenda?
- » Why is financial management important to SMEs?



Preliminary assessments performed

- » Testing a version 1.0 assessment methodology in Albania and Serbia
- » Is qualitative, relying on Survey and Discussion
- » The methodology aims to identify key priorities for improving SME financial management and financial governance at MSMEs:
 - » Identify deficiencies as observed by stakeholders
 - » Identity constraints to improvement as observed by stakeholders
 - » Assessing the capacity of PAO(s) to be a change-agent through self-assessment
 - » Providing stakeholders with input for an action roadmap



Assessment performed- Albania and Serbia

Stakeholder input was obtained through surveys and interviews of the following types of organizations:

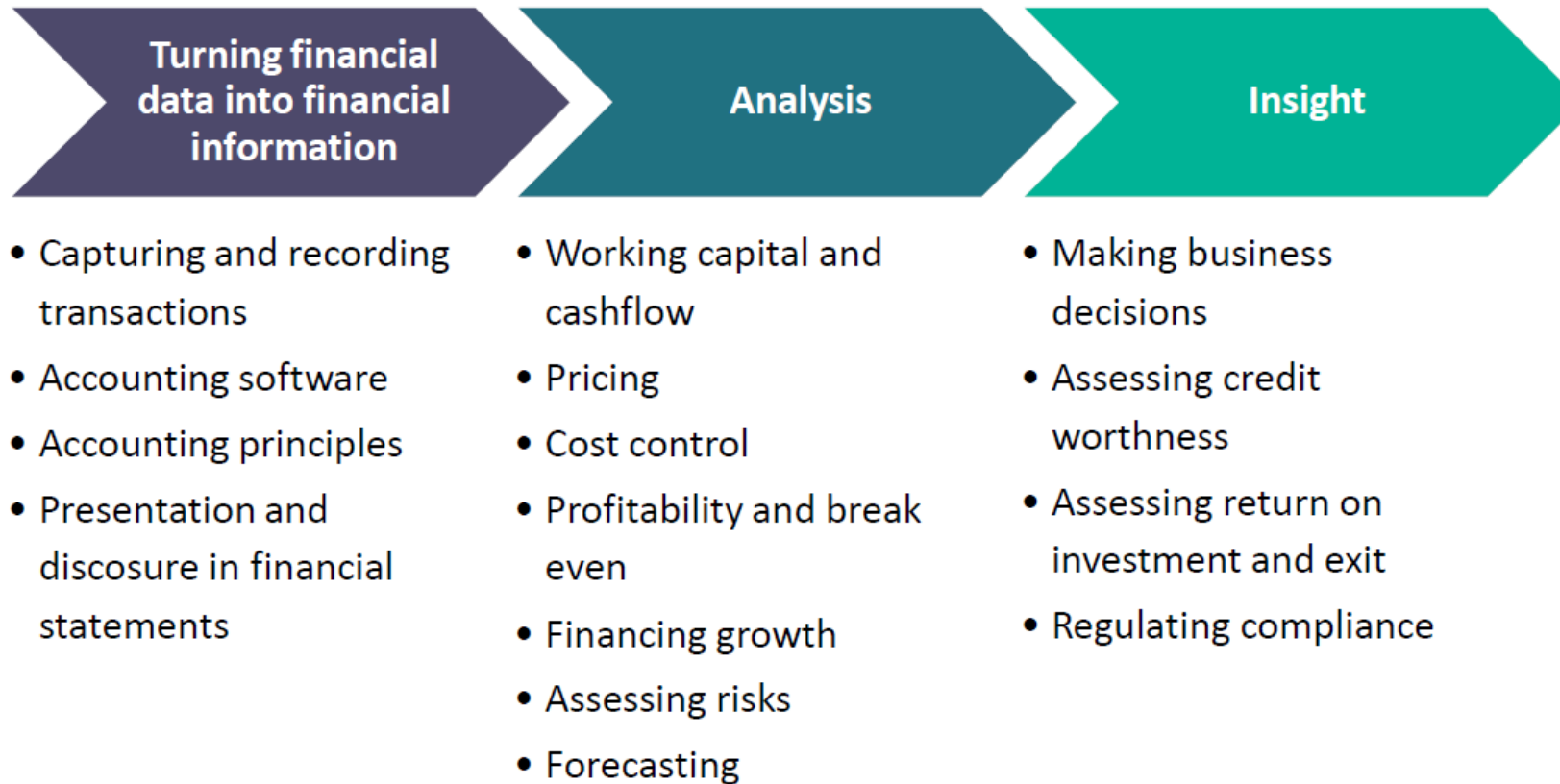
- MSMEs
- Small and Medium-sized accountancy Practitioners (SMPs)
- Professional Accounting Organizations (PAOs) and accounting associations
- Chambers of Commerce
- Banking Associations
- Development Agencies
- Insolvency Practitioners
- Banks
- Investors
- Ministries of Economy and Finance, and
- EBRD

What is financial management?

For A4G, financial management refers to the systems and practices that MSMEs use to capture financial data and information and turn it into financial knowledge and insights for use in effective management of business finances and making business decisions, including by external stakeholders assessing the credit worthiness and 'investibility' of MSMEs.



What is financial management?





The challenge with SMEs as a target for private sector development

- » Heterogeneous: No one-size-fits-all approach can work
- » Some SMEs are not focused on growth
- » SME owners have differing levels of financial literacy
- » SMEs are at different points in the life cycle and have different needs and potential to grow

SME Financial Management deficiencies identified



Poor record keeping	<p>Many smaller MSMEs have poor recording keeping and management reporting systems in place. In many cases the owner or family member will perform bookkeeping in other cases MSMEs outsource to 'bookkeepers' who compete solely on price, rather than quality.</p> <p>Poor record keeping means that it is difficult to reliably determine the financial position, financial performance and cash flows of the SME on a regular basis. Without credible financial information it is difficult to keep a control on the financial health of the MSMEs (and have other interested external parties determine it).</p>
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SME Financial Management deficiencies identified



Over indebted	There are not many options for MSMEs seeking financial capital outside of the banking system. There appear to be several observers who hold the view that banks take advantage of this.
Poor liquidity and cash management	<p>It is imperative that MSMEs can pay their creditors and staff on time. This requires ongoing management of MSMEs' cash balances, which stakeholders often cite as not performed very well in Serbia by MSMEs.</p> <p>There are number of challenges in Serbia that make cash management especially important, for example; making payments of VAT before receiving the VAT from payments from customers.</p>

SME Financial Management deficiencies identified



Taxation (direct and indirect)	Tax and related filings are not accurate.
Lack of financial control and performance monitoring	Not having a budget. Not comparing actual costs with budgeted/forecasted costs and following up on these differences.

SME Financial Management deficiencies identified



Lack of risk management	While some SMEs have identified risks and attempt to mitigate these, many do not have robust processes to identify and manage business risks.
Poor business and operating models	Many MSME owners do not approach running their businesses strategically and they do not see them as a model that generates value. Rather, MSME owners are often narrowly focused on production and service processes only and while these are important they can be looking at their businesses with a narrow lens.

SME Financial Management deficiencies identified



Unreliable revenue and profit forecasts	MSME owners tend to be too optimistic about the performance of their businesses when it comes to forecasting revenues and cash flows and underlying assumptions tend to be unrealistic. Unfortunately, this means that these numbers are often discounted by those looking to assess the ability to service debt repayments.
Lack of financial transparency	MSMEs are generally considered to produce unreliable annual reports and financial statements. Research in Serbia has found that the quality of financial statements are a determinant in the cost of debt (Stanisic, Stefanovic and Radojevic 2015).

SME Financial Management deficiencies identified



Board of Directors fulfills a legal requirement only	A commonly cited issue with the way MSMEs are managed in Serbia is that the owner is doing everything and there is no separation between ownership and management functions.
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Factors that lead to these deficiencies

- Limited access to modern accounting software/technology
- Bank lending practices
- Limited alternatives to debt
- Limited financial literacy of owner(s)
- Ineffective governance structures and practices
- Underqualified accountants and qualified accountants who have a skills gap
- Complex tax system with burdensome administrative requirements
- Low demand for financial statements
- Lack of enforcement of financial reporting requirements



Broad strategies for change

HUMAN CAPITAL

- Making the professional accounting designation more attractive for talented individuals to join the accounting profession, especially once demand for financial management increases
- Improving the quality of professional development education both at entry in the profession and thereafter
- Increasing the reach of initiatives that transfer financial knowledge to entrepreneurs for improved financial literacy
- Reinforcing professional accountants as ethical leaders that provide value added services to business



Broad strategies for change

TECHNOLOGY

- Helping MSMEs gain access to improved accounting and finance technology that can reduce transactional costs and provide a platform for increased demand for business analysis and financial management
- Removing barriers to effective usage of improved technology (e.g. full integration of accounting systems and banking systems, data storage and overly complex requirements like VAT etc.)



Broad strategies for change

REGULATION

- Strengthening incentives for MSMEs to improve financial reporting and increase demand for good financial management practices
- Keeping audit thresholds as high as possible but considering alternative ways to add credibility to financial statements of MSMEs



Broad strategies for change

STRENGTHENING INSTITUTIONS

- Strengthening the capacity of the PAOs to build a strong accounting profession to support MSMEs (and other institutions for non-professionals)

THOUGHT LEADERSHIP

- Researching how current financial management and financial governance practices constrain MSME Sector growth and the effectiveness of improving skills and technology to removing these constraints



Challenges

Overcoming low demand for financial management and financial governance by business owners

Strengthening the PAOs to improve the image of the profession and awareness of services to the public, provide more relevant services to members to support improved relevance to MSMEs and play a stronger role in advocating for an improved MSME business environment.

Getting institutions that have a role in the National MSME Development Plan to crowd-in and collaborate and coordinate more closely.



Challenges

Developing a start-up eco-system that can bring technological solutions to MSMEs' financial management problems

Improving the capacity of a diverse group of financial management employees and service providers, that are not professional accountants, to improve their practices

Defining priorities for development activities



Let's discuss.

Questions for discussion- how to move this agenda forward?

1. From what you've heard, what changes would you make to assessment methodology?

2. What other strategic areas are important to make improvements?

3. What other challenges do you see in implementing strategies to improve financial management in SMEs throughout the region?

4. What other stakeholders are important to engage in this work?

5. Should we spend the time to make an assessment in the other countries or just rely on what was performed in Albania and Serbia as being a reasonable reflection for the region?

6. What specific project activities do you think may be helpful in the implementation phase of this work?