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Determinants of Accounting Practice in Micro and Small Enterprises: Evidence from South Western Wollo, Ethiopia

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ABSTRACT

This study is aimed to assess the factors that determine the absence, presence and degree of accounting recordkeeping among micro and small enterprises in South Western Wollo region in Ethiopia. It has been noted that, despite the enormous importance of accounting recordkeeping, the practice is still inadequate in micro and small businesses. This study used a cross sectional primary data collected from 343 micro and small enterprises. An ordered logistic regression analysis method was employed to analyze the effect of explanatory variable (education level, number of employees, frequency of transactions, size of the firm, and age of the firm) on accounting practice of micro and small enterprises. The results of the study show that education level, the number of employees, the frequency of transactions and the size of the firm have a statistically significant and positive effect on the accounting practice of micro and small enterprises. On the other hand, the age of the firm is found to have no statistically significant effect on the accounting practice of micro and small enterprises. This study will help micro and small enterprises by showing the major factors that affect their accounting practice and working towards the betterment of their reporting and decision making habits.

ABSTRAK

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1. Introduction

In many countries, micro and small enterprises are regarded as the major elements and engines to economic growth and stability. Micro and small enterprises are significant drivers of economic development, especially in developing economies (Obi, 2015). Micro and small enterprises are the means to transform from agricultural economy to industrialization. With little capital to invest, it seems obvious that the process of industrialization should be based on the development of the micro and small enterprises to link agricultural production with value adding manufacturing activities (Sushimita & Jibon, 2017). Micro and small enterprises constitute a significant proportion of business firms all over the world and play a significant role in the economy, such as creating employment opportunities, production of goods and provision of services, improving standard of living and largely contributing to the gross domestic products (GDPs) of many countries (OECD, 2000).

Small businesses help to reduce poverty by creating jobs for the country's growing labor force and stimulate economic development in both rural and urban areas. In addition they serve as valuable partners to large enterprises as suppliers of inputs, as customers to distribute their products and providers of support services. A lively MSE sector is an indication of a thriving and growing economy. Despite policies that aim to provide an enabling environment for MSME development, the sector still faces various constraints that prevent it from realizing its full growth and potential (Senate of the Philippines, 2012).

The Ethiopian government is currently implementing the second Growth and Transformation Plan (2008 – 2012 E. C), with a vision of becoming one of the middle income countries by 2025. In line with this long term vision, the government is formulating and implementing different strategies to promote the development of micro and small enterprises. Nevertheless, the enterprises promotion to a larger business is overlooked. Instead the government is focused on investment on the establishment of new enterprises (Abawa & Raghurama, 2017).

However, due to many internal and external factors, such as financial problems, lack of business knowledge, infrastructural and location problems, high cost of financing and inappropriate pricing, many new and existing micro and small enterprises are failed to achieve their objectives and unable to win competitions. Due to this reason numerous micro and small enterprises are forced to go out of business. One way or another, many of these problems faced by micro and small enterprises are associated with accounting practices and they can be minimized by keeping proper accounting records (Raihanna et al., 2017). Proper recording of business activities and transactions can help them in the decision-making processes for micro and small business owners (Mary-Jo, 2016).

Good accounting practice is manifested by activities such as keeping accurate and consistent record of revenues, expenditure, purchases, receipts, payroll, tax, invoices, changes in assets, and consistent application of accounting methods and internal control procedures (Agir, 2017).

Keeping proper accounting records will have many advantages for every type of organization, whether it is small or big as financial information allows entrepreneurs to make informed business decisions (Belverd et al., 2011). It provides information for managers that can be used in the day to day operations of the business. In addition, accounting information is provided to other internal and external stakeholders who are interested in assessing the economic performance and condition of the business (Warren, 2005). It will help to make informed decisions, manage and control business activities, enables to stay organized and be systematic in its relation with customers and suppliers, help to know the operational performance, financial position, tax returns and other information about the business and making plans and forecasts based on these information. In addition, preparing accounting reports can help to get access to bank loan and other credits and make better investments decisions. Proper record keeping can improve the effectiveness and efficiency of micro and small enterprises. This means Micro and small enterprises that

have proper recordkeeping practices are likely to have improved operating performances (Chukwuma et al., 2017; Hashim, 2011). Alhassan (2017) states that firms that keep proper accounting records can be able to make better decisions and make business adjustments accurately. In addition, accounting information can help them to have reduced operating costs and improved efficiency and productivity. Despite the enormous importance of accounting recordkeeping, unfortunately the practice is still inadequate in the micro and small enterprises sector (Mosisa, 2011).

It has been ascertained that most small-scale enterprises fail to keep proper books of account and also fail to observe basic accounting procedures that can help to control its resources. As a result, they are not able to reveal the exact financial position and operational performances of their businesses. The main reasons for poor accounting recordkeeping include: smallness of the business, expensiveness of hiring qualified accountants, lack of basic accounting knowledge, and lack of awareness about the benefits of accounting information (Girmachew & Girma, 2019; Kipsang & Mwangi, 2017; Mersha & Ayenew, 2017).

The financial statements, such as the profit and loss accounts, the balance sheet and the cash flow statement of small-scale enterprises cannot easily be prepared. Under such circumstances, annual profits or losses cannot easily determined (Hashim, 2011).

It is important to state that the absence of proper records does not only impair the growth of the small-scale enterprise but also, as stated by World Bank in 2016 it reduces their chances of obtaining credit facilities from the financial institutions and other fund lenders. Similarly Edris & Fredu (2016) indicated that poor financial records has significant effect on access to finance. Because creditors use financial reports and records of their client as source of information, to evaluate payment capacity and creditworthiness of borrowers. In addition this financial information can be used to make investment or divestment decisions. So studying the factors that determine accounting practices is vital.

2. Empirical Literature and Hypotheses

Literature on the determinants of accounting practices are very limited. Most studies conducted on the accounting practice of Micro and small enterprises in Ethiopia mainly focused on their accounting practice condition and a little is investigated about the reasons why they fail to practice accounting. The following section provides the empirical findings of prior researches and hypotheses on the effect of determinant variables on accounting practice.

Relationship between Firm's Age and Accounting Practice

Firm's age is the number of years for which micro and small enterprises stay in operations in their current business. A study by Mosisa (2011) on small and medium enterprises in Addis Ababa, Ethiopia found that the age of company have significant influence on their accounting practice. Another study by Girmachew and Girum (2019) concluded that the age of the firm significantly affects accounting recordkeeping of micro and small enterprises in Debre Birhan City, Ethiopia. On the other hand, Padachi (2012) indicated that the age of the firm have no significant influence the adoption of formal accounting systems. Looking into the above findings, researchers formulated the following hypothesis.

Ha1: Firms' age have statistically significant effect on accounting practice of micro and small enterprises in South Western Wollo, Ethiopia.

Relationship between Education Level and Accounting Practice

Education level is the academic background and status of the key personnel in the firm. Kipsang & Mwangi (2017) showed that education level significantly affects accounting practices of small and micro enterprises in Kenya. A study by (Arsemakedest, 2015; Mosisa, 2011; Girmachew and Girum, 2019) also concluded that education level significantly affects accounting practices of micro and small enterprises.

Looking into the above findings, researchers formulated the following hypothesis.

Ha2: Education level have statistically significant effect on accounting practice of micro and small enterprises in South Western Wollo, Ethiopia.

Relationship between Number of Employees and Accounting Practice

A study by Daniel & Shaik (2017) noted that the majority of small and medium enterprises did not produce organized accounting reports. Lack of man power accounts for 31.25% of the reasons behind the failure of their accounting practice. Another study by Agir (2017) showed that the accounting practice of SMEs is challenged by their shortage of trained manpower. The use of accounting recordkeeping differ between SMEs having different number of employees (Kipsang, 2012). Looking into the above findings, researchers formulated the following hypothesis.

Ha3: Number of Employees have statistically significant effect on accounting practice of micro and small enterprises in South Western Wollo, Ethiopia.

Relationship between Frequency of Transactions and Accounting Practice

Frequency of transactions is the average number of transactions that occurs in the firm per day. It seems that firms that have frequent transactions will have a higher tendency to practice accounting. This is because firms with many transactions have a higher magnitude of profit and have a higher number of credit transactions. So it is expected that they tend to have a record of their sales and purchase transactions. Looking into the above findings, researchers formulated the following hypothesis.

Ha4: Frequency of Transactions have statistically significant effect on accounting practice of micro and small enterprises in South Western Wollo, Ethiopia.

Relationship between Firm's Size and Accounting Practice

As indicated by Padachi (2012), as the size of the firm, measured by its net assets increases, the likelihood of keeping formal accounting records increases. A study by Mosisa (2011) also indicated that the size of the company measured by its total capital have significant effect on accounting practice. Looking into the above findings, researchers formulated the following hypothesis.

Ha5: Firm's Size have statistically significant effect on accounting practice of micro and small enterprises in South Western Wollo, Ethiopia.

3. Research Method

This study employed explanatory research design to determine the cause-effect relationship between the dependent variables and the dependent variable [see figure 1].

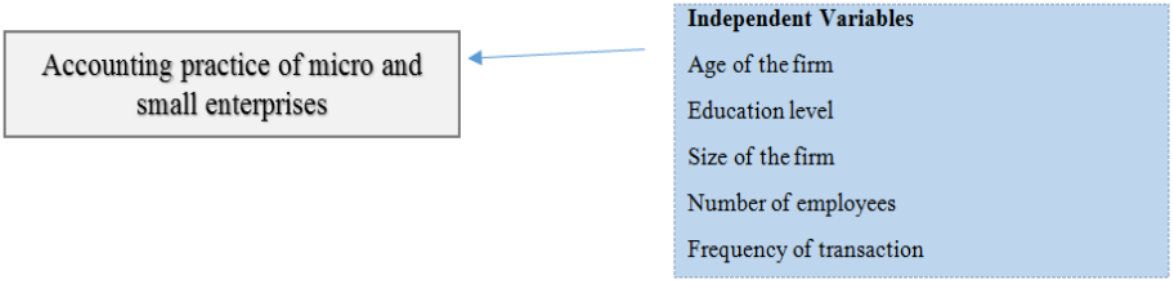

Figure 1. Conceptual framework

The total population of the study is 2,429 micro and small enterprises found in Borena and Legambo districts of South Western Wollo, Ethiopia. A sample size of 343 micro and small enterprises was determined using a formula developed by Yemane (1967).The researchers selected the respondents by using a stratified random sampling technique. A total of five (5) strata was formed by using the type of business activity in which micro and small enterprises are engaged namely service, merchandising, manufacturing, urban agriculture, and construction business. The total sample size is divided among each strata proportionately. Primary data was collected using close and open-ended questionnaire distributed to owners and managers of micro and small enterprises. The collected data was analyzed using ordered logistic regression analysis model conducted on *IBM SPSS Statistics 20* software.

4. Data Analysis and Discussion

4.1. Ordinal Dependent Variable

In order to use the ordered logistic regression model, the response variables should be measured in ordinal terms. The dependent variable of this study (Accounting practice) is ranked into four ordinal levels.

Table 1. *Measurement of the dependent variable (Accounting practice).*

Level 1	No accounting practice
Level 2	Record transactions with single entry
Level 3	Record transactions with double entry and prepare reports
Level 4	Prepare formal financial statements

4.2. Tests of Model Fitness

Table 2. *Model Fitting Information.*

Model Fitting Information				
Model	**-2 Log Likelihood**	**Chi-Square**	**Df**	**Sig.**
Intercept Only	703.644			
Final	228.326	475.318	5	.000

Link function: Logit.
Source: SPSS analysis output

As shown on table 2, the p-value (Sig.) is less than 0.05. So that we can say the model gives a better description of the data and a better prediction of the outcome. The Chi-Square result shows that there is a significant improvement in fit of the final model than the model with the intercept only. The appropriateness of the model for the data set can be further evidenced by the "Goodness-of-fit test.

Table 3. *Goodness-of-Fit test.*

Goodness-of-Fit			
	Chi-Square	**df**	**Sig.**
Pearson	715.087	256	.300
Deviance	144.899	256	1.000

Link function: Logit.
Source: SPSS analysis output

As per table 3, the p-value is not significant because its value is greater than 0.05. There is no reason to reject the null hypothesis. So we have to accept that the model is a good fit to the dataset under analysis.

Table 4. *Pseudo R-Square test.*

Pseudo R-Square	
Cox and Snell	.750
Nagelkerke	.821
McFadden	.567

Link function: Logit.
Source: SPSS analysis output

Table 4 shows that the R-Square of the model is 0.821, which means, about 82.1% of the variation in accounting practice is explained by the model.

4.3. The Assumption of Proportional Odds

The assumption of proportional odds assumes that for each term included in the model, the estimated slope between each pair of outcomes across two response levels are the same. The test for the assumption of proportional odds is referred to as the test of parallel lines. The result of test of parallel lines applied on the dataset is shown in tables 4-6 below.

Table 5. *Test of Parallel Lines*[a].

Model	**-2 Log Likelihood**	**Chi-Square**	**Df**	**Sig.**
Null Hypothesis	69.136			
General	57.321	35.369	9	.224

a. Link function: Logit.

The null hypothesis states that the location parameters (slope coefficients) are the same across response categories.

The result of test of parallel lines shown on table 5, indicates that the p-value (sig.) is not significant (it is greater than 0.05), which enables us to accept the null hypothesis, i.e., the slope coefficients are the same across different response categories.

4.4. Test for Autocorrelation

Table 6. *The Durbin Watson test.*

Model Summary[b]	
Model	**Durbin-Watson**
1	2.231[a]

a. Predictors: (Constant), Frequency of Transactions, Education Level, Firm Size, Number of Employees, Firm Age.
b. Dependent Variable: Accounting Practice.

Table 6, shows that the dataset have a relatively normal autocorrelation status that is acceptable to make the regression analysis.

4.5. Test for multicollinearity

Table 7. *VIF test for multicollinearity.*

Coefficients[a]			
Model		**Collinearity Statistics**	
		Tolerance	**VIF**
1	Firm Age	.626	1.377
	Firm Size	.255	3.923
	Education Level	.981	1.020
	Number of Employees	.123	2.105
	Frequency of Transactions	.087	2.529

a. Dependent Variable: Accounting Practice.

According to table 7, all the values of VIF test for the explanatory variables are in a range of 1 – 10. This indicates that there is no symptom of multicollinearity problem in the dataset.

4.6. Regression Estimates

Since the nature the dependent variable of this study (Accounting Practice) is an ordered one, we use the ordered logistic regression model to estimate its statistical relationship with the explanatory variables. The output of

Table 8. *Ordered Logistic Regression Output.*

Parameter Estimates								
		Estimate	**Std. Error**	**Wald**	**df**	**Sig.**	**95% Confidence Interval**	
							Lower Bound	Upper Bound
Threshold	[ACP = 1]	28.274	3.858	53.714	1	.000	20.713	35.835
	[ACP = 2]	33.694	4.035	69.738	1	.000	25.786	41.602
	[ACP = 3]	36.789	4.165	78.016	1	.000	28.625	44.952
Location	Age	.130	.115	1.268	1	.260	-.096	.355
	Educ	1.196	.354	11.410	1	.001	.502	1.890
	Emp	.442	.216	4.169	1	.041	.018	.866
	Ftrxn	.195	.088	4.929	1	.026	.023	.367
	LnSize	3.802	.844	20.266	1	.000	2.147	5.457

Link function: Logit.
Source: Computed with SPSS 20 Software

The discussion of the results of ordered logistic regression estimates is as presented below.

i. Firm Age and Accounting Practice

As indicated on table 8, the sig. value of the explanatory variable "Age" is 0.26, which is higher than the 0.05, so that we cannot reject the null hypothesis. So we can conclude that Firm's Age have no a statistically significant effect on accounting practices of Micro and small enterprises. This result is in agreement with the result of Padachi (2012), which concluded that the firms age have no significant effect on accounting systems of small and medium enterprises. On the other hand the result is against the findings of

(Girmachew & Girma, 2019; Mosisa, 2011) which concludes that firm's age have significant effect on accounting practice.

ii. Education Level and Accounting Practice

As per table 8, the sig. value of education is 0.001, which is less than 0.05 with a positive coefficient. This enables us to reject the null hypothesis and accept the alternative hypothesis, i.e., education level have a statistically significant positive effect on the accounting practice of micro and small enterprises. The regression coefficient of this variable is 1.196, which can be interpreted as, given that all the other predictor variable in the model constant, for a one level increase on the educational status, there is a predicted increase of 1.196 in the ordered log odds of having a higher degree of accounting practice. This outcome is in conformity with the findings of (Arsemakedest, 2015; Kipsang & Mwangi, 2017; Mosisa, 2011). They concluded that the application or the use of manual or computerized accounting practice increases with education level. The result of a study by Padachi (2012) shows that Education level have no significant effect on accounting systems of small and medium enterprises and another study by Wijewardana ()2018) shows that Education level (financial accounting skill) have no significant effect on accounting system of small and medium enterprises.

iii. Number of Employees and Accounting Practice

The sig. value of the number of employees is 0.041, which is lower than 0.05. This can enable us to reject the null hypothesis and accept the alternative one, i.e., the number of employees have a statistically significant positive effect on accounting practices of micro and small enterprises. Looking at the regression coefficient of this variable, we can say that, holding all the other predictor variables in the model constant, for a one unit change in the number of employees of the Micro and small enterprises, the ordered log odds of being in a higher degree of accounting practice is expected to increase by 0.442. This result contradicts with the conclusion of Padachi, (2012) which stated that the number of employees have no statistically significant effect on accounting practice of SMEs.

iv. Frequency of Transactions and Accounting Practice

Referring to table 8, the sig. value of frequency of transactions (0.026) is lower than 0.05. So we can reject the null hypothesis and instead accept the alternative hypothesis, i.e., the Frequency of transactions have a statistically significant positive effect on accounting practices of micro and small enterprises. We can conclude that, the average number of daily transactions that occurs in the company significantly affects the accounting practice of micro and small enterprises. Looking into the coefficient of this variable, keeping the other predictor variables constant, it is predicted that if the frequency of transactions increases by one unit, the log odds of being at a higher degree of accounting practice will increase by 0.195.

v. Firm Size (LnSize) and Accounting Practice

The size of the firm is measured by the natural logarithm of total assets. As indicated on table 8, the sig. value of the size of the firm (.000) is lower than 0.05. So we accept the alternative hypothesis, i.e., a Firm's Size have a statistically significant positive effect on accounting practices of Micro and small enterprises. The positive regression coefficient of this variable tells us that, keeping the other explanatory variables constant, for every one unit increase in the value of firm size, there is a predicted increase of 3.802 in log odds of being at a higher degree of accounting practice of micro and small enterprises. This finding agrees with the finding of (Padachi, 2012; Mosisa, 2011) that the size of the company measured by its capital have significant effect on accounting practice.

5. Conclusions, Implication, Limitations and Suggestions

Based on the findings of the study, the researchers have made these conclusions. Firm's Age is found to have no significant effect on the accounting practices of micro and small enterprises. Education level have

a statistically significant positive effect on the accounting practice of micro and small enterprises. Holding the other variables in the model constant, we can say that if the key personnel in the company is in a higher level of education, there will be a higher degree of accounting practice in small and medium enterprises. In addition, the number of employees, frequency of transactions, firm size is found to have a statistically significant positive effect on accounting practices of micro and small enterprises.

This study used five variables and there might be other variables which will have an effect on accounting practice. In addition, micro and small enterprises included in this study are from two districts. Other districts in the study area are excluded because of lack of sufficient data. Future researchers are recommended to include other variables and micro and small enterprises in other districts as well.

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