Management Accounting: A Tool to Achieve Entrepreneurial Goals

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Since entrepreneurship is essential for economic development, the policy makers are trying to boost entrepreneurial activity across the nation. It is found that one of the main reasons for the failure of a business is lack of proper exposure to the accounting process, especially usage of management accounting. Therefore, this study has been carried out with the objective to determine the role of management accounting in achieving the entrepreneurial goals. The study uses purposive sampling method for collection of data and chi-square test to test the hypothesis. The findings reveal that management accounting information leads to effective decision making, which is crucial for achieving the entrepreneurial goals.

Introduction

Entrepreneurship plays a crucial role in the economic development of a nation. Having realized this, the policy makers have been giving due importance to the growth of entrepreneurship among its citizens. The government has been putting in efforts to boost the entrepreneurial activity through policy interventions, market development, incentives, easy availability of finance, infrastructural development, etc. Despite all such efforts, the nation is witnessing business failures, resulting in negative growth of the economy. Though we have seen intensive financing of these enterprises, the results of the present study show that there is a lack of expertise in terms of handling the finances, especially the making of financial decisions without proper knowledge of management accounting.

An entrepreneur has to quantify the financial needs of his/her business and estimate the amount of money required to purchase various assets. The amount will be needed for purchasing the fixed assets and meeting working capital requirements. The funds needed in the future should also be taken into consideration. After making financial planning, the next task will be to acquire funds. There are a number of sources available for providing funds and selection of an appropriate source is a crucial task. The choice of a wrong source for funds may create difficulties at a later stage. The pros and cons of various sources should be

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analyzed before making a final decision. The funds should be used in the best possible way. The cost of acquiring them and the returns should be compared. The channels which generate higher returns should be preferred. The technique of capital budgeting may be helpful in selecting a project. The objective of maximizing profits will be achieved only when funds are efficiently used and do not remain idle at any time. An entrepreneur has to keep in mind the principles of safety, liquidity and soundness while investing funds. Apart from this, every concern is required to maintain some liquidity for meeting day-to-day needs. It is required to purchase raw materials, pay workers, meet other expenses, etc. Thus, an entrepreneur is required to determine the need for liquid assets and then arrange liquid assets in such a way that there is no scarcity of funds (Gupta and Sharma, 2006).

This paper makes an attempt to study the linkage between the use of accounting information and achievement of the entrepreneurial goals. This study is also necessitated due to the fact that though entrepreneurship is being encouraged at all levels, it is not turning into sustainable growth. Statistically, 90% of the startups in India fail within the first five years of establishment (Agarwal, 2017). Despite such positive environment for the entrepreneurs, systematic causes of failure should be enquired into through a research study. Various papers, viz., Haron and Shanmugam (1994), Mehralizadeh and Sajady (2005), Nawawi *et al*. (2010), Patnia (2014), etc., published recently on factors responsible for determining the causes of failure, prima facie, disclose that lack of accounting information tends to be a reason for such phenomena. Thus the objective of this study is to determine the role of management accounting to achieve the entrepreneurial goals.

The fundamental function of management accounting is to support the entrepreneurs through informed decision making. Unfortunately, not much attention has been paid to management accounting in small and medium-sized firms largely operated by first generation entrepreneurs. Hence, studies in this regard must be carried out so that effective financial decision making may be developed with concrete mechanism.

Literature Review

There is extensive literature available on the causes of failure in achieving entrepreneurial goals, but given the objective of our study, the review of literature is confined to financial decisions only. Inefficient financial management has been posted as the main reason for failure of the medium and small scale enterprises (Longenecker *et al*., 2006) because there happens to be a direct link between enterprise outcomes and the depth of expertise in organizational management, especially in terms of decisions based on management accounting. Expertise and usage of accountancy are important aspects that influence positively the achievements of the entrepreneurial activity. Absence of proper bookkeeping and its use in financial as well as operational decisions leads to the collapse of the business within very short span of time (Sherman, 2009). The gist of the matter is that accountancy is an important element which an entrepreneur cannot afford to overlook and it is imperative for profitable business. Thus, this study develops a hypothesis that for achievement of entrepreneurial goals, proper use of accounting information is necessary.

Data and Methodology

This study focuses on the new forms of corporate entities like Limited Liability Partnerships (LLPs) and One Person Companies (OPCs). The study has selected 70 LLPs and 40 OPCs through purposive sampling method. The selected entities are first generation entrepreneurs having their area of operation in the State of Rajasthan and have shown positive signs in terms of capital-output ratio.

The relevant data has been collected from primary as well as secondary sources. Primary data was collected through survey (see Appendix) and interviews, and secondary data was collected from the financial information available on the Ministry of Corporate Affairs website.

Hypothesis

H_0: There is no link between use of management accounting and entrepreneurship success.

Results and Discussion

Awareness of Management Accounting

Table 1 shows that 64.54% of the respondents are aware of management accounting that supports the financial decision making. This also reflects flexible education syllabus having glimpses of financial curriculum.

Table 1: Frequency Distribution of Respondents According to Awareness of Management Accounting

Awareness	Frequency	Percent
Yes	71	64.54
No	39	35.46
Total	**110**	**100.00**

While enquiring about the awareness of management accounting, specific techniques of management accounting have been discussed. Since respondents are first generation entrepreneurs and operating their establishments under financial constraints coupled with intense competition, emphasis remains on cost analysis and budgetary control. Respondents who answered in the affirmative are sensitive towards various concepts of cost like fixed cost, variable cost, total cost and marginal cost. One respondent shared his experience as to how he made profits through differential costing method under stiff competition from other suppliers. Moreover, at present, all the procurements in the formal sector are being made through a tender process where prospective suppliers are required to make bid in order to acquire the supplying contract. Thus management accounting helps in quoting very competitive bid through different techniques of cost-volume-profit analysis, and these entrepreneurs have been showing the practice of starting new business organization or product in response to identified product price opportunities.

One respondent who is not aware of the usage of management accounting reveals that he has lost some supply offers as cost of his product is not competitive. On analysis, it was found that while pricing his product he has simply used absorption costing method instead of determining his marginal cost of product, in which case, he would have grabbed these orders by offering competitive prices. Similarly, respondents who are unaware of management accounting would complain about inefficiency and wastages. They fail to establish any standard relating to product or responsibilities and deprived themselves of continuous comparison of actual with budgeted results to secure any improvement in their performances.

Usage of Management Accounting in Decision Making

The findings in Table 2 depict that 46.36% of the respondents strongly agree that management accounting is useful in financial decision making. In addition, 31 respondents admit that things would have been different had they applied information derived out of management accounting in their decision making process. More often considerations for choice making have been related to (1) acquire or hire, (2) make or buy, (3) sell or process further, and (4) accept or reject an order.

Table 2: Frequency Distribution of Usage of Management Accounting in Decision Making

Useful in Decision Making	Frequency	Percent
Strongly Agree	51	46.36
Agree	28	25.45
Not Sure	19	17.27
Disagree	08	07.27
Strongly Disagree	04	03.64
Total	**110**	**100.00**

The respondents who strongly agree to use management accounting in decision making reveal that they realize the importance of choice making. It enables them to separately analyze each available alternative to determine how every alternative changes or influences their choice in order to achieve optimum organizational efficiency. Many qualitative and quantitative elements have to be taken into consideration in effective decision making. The rational decision making involves prediction, which though unable to change the past, certainly affords room to improve future outcomes.

The respondents who disagree with the usage of management accounting in decision making quote that in the present era of information technology where all necessary and unnecessary information is available in galore, the inevitable result emerges, per se, when it comes to computation and interpretation of analysis. In fact, they argue many points resembling the doctrine of 'bounded rationality' where whatever decisions they have taken, given their limited resources turn out to be the best decisions. However, considering the competitive market structure and complex financial environment, they acknowledge the importance of management accounting.

Link Between Management Accounting and Entrepreneurial Success

For the overall entrepreneurial success, capital-output ratio is considered. Capital-output ratio in general terms is the quantum of investment required to generate output worth ₹1.

If Y stands for output or income and K for the capital invested to produce that output, then K/Y represents capital-output ratio. Higher capital-output ratio can be considered as a measure of inefficiency with which capital is being used. Considering the current market scenario, we consider capital output ratio of 0.25 as efficient use of capital. Thus the respondents are grouped according to less than 0.25 and more than 0.25. The average capital output ratio is also calculated as 0.27 and its descriptive statistics are given in Table 3.

Table 3: Descriptive Statistics of Average Capital-Output Ratio for the Last Three Years as on March 31, 2017

Mean	0.2720775	Standard Error	0.018887	Kurtosis	13.8843129	Range	1.42821035
Median	0.20336867	Standard Deviation	0.19808854	Skewness	3.01305703	Minimum	0.07914242
Mode	N/A	Sample Variance	0.03923907	Sum	29.9285251	Maximum	1.50735276

The bivariate frequency distribution of the capital-output ratio with usage of management accounting is shown in Table 4.

Table 4: Average Capital-Output Ratio for Last Three Years as on March 31, 2017

Management Accounting	Average Capital-Output Ratio		
	Less Than or Equal to 0.25	**More than 0.25**	**Total**
Yes	49	15	64
No	20	26	46
Total	**69**	**41**	**110**

There are 49 entities which have adopted management accounting having a capital-output ratio of less than or equal to 0.25 times. On the other hand, 15 entities have adopted management accounting having a capital-output ratio of more than 0.25 times. In the case where management accounting is not used, 20 entities have a capital-output ratio of less than or equal to 0.25 times and 26 entities have a capital-output ratio of more than 0.25 times.

Testing of Hypothesis

Applying χ^2 test:

$$\text{Expectation of } (AB) = \frac{(A)\times(B)}{110}$$

$$= \frac{69\times64}{110} = 40.14$$

Or E_1, i.e., expected frequency corresponding to first row and first column is 40.14. The expected frequencies are shown in Table 5.

Table 5: Expected Frequencies			
Management Accounting	Capital-Output Ratio		Total
	Less than or Equal to 0.25	More than 0.25	
Yes	40.14	23.86	**64**
No	28.86	17.14	**46**
Total	**69.00**	**41.00**	**110**

As per the calculation of chi-square test, the expected frequencies have replaced actual frequencies: 49 by 40.14, 15 by 23.86, 20 by 28.86 and 26 by 17.14 (see Table 6).

Table 6: Calculations for Chi-Square Test				
O	**E**	**(O – E)**	**$(O – E)^2$**	**$(O – E)^2/E$**
49	40.14	8.86	78.4996	1.955645
15	23.86	–8.86	78.4996	3.290008
20	28.86	–8.86	78.4996	2.720014
26	17.14	8.86	78.4996	4.579907

$\chi^2 = [\Sigma\,(O - E)^2/E] = 12.54557$

$\nu = (r - 1)\,(c - 1) = (2 - 1)\,(2 - 1) = 1$

For $\nu = 1$, $\chi^2_{\ 0.05} = 3.84$

Since the calculated value of χ^2, i.e., 12.54557, is greater than the table value, i.e., 3.84, the null hypothesis is rejected, leading to acceptance of alternative hypothesis that there is positive impact of usage of management accounting information on the success of entrepreneurial activities.

Conclusion

The findings revealed that management accounting information leads to effective decision making which is crucial for achieving entrepreneurial goals. During the study, some of the respondents revealed that they are running very small units and are unable to hire accounting experts. It may happen that while starting a new venture, the entrepreneur may be struggling financially and may not be able to hire experts. But with no knowledge of accounting, they have no way to monitor the effectiveness of the enterprises. Entrepreneurs do not have adequate understanding of capital budgeting and that is why their capital-output ratio is not so good. They are indecisive whether to lease or own when they avail of any heavy asset. It is observed that today's fast changing era has led to too much of customization, and thus individuals prefer to own assets instead of leasing. Soon such assets become obsolete, leaving the business in a state of loss, and it also impacts its capital turnover ratio (Jarwal and Kahal, 2017).

Thus, the outcome of the study strongly recommends formal accounting training of entrepreneurs. Education is crucial to enable entrepreneurs to gain knowledge on usage of accounting. This may be through conferences, seminars, workshops and short-term courses. Knowledge of accounting enables entrepreneurs to understand the financial records and also to make decisions to correct or modify any area of financial concern in their business operations. Accounting-based decisions may include anything from expansion of business area to justifiably pricing the goods or services they produce. Accounting maintains updated information about loan liabilities, outstanding amount of debtors/creditors, equipment depreciation, etc. Thus entrepreneurs will benefit greatly through the usage of management accounting in the decision-making process.■

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Appendix

Questionnaire

1. **General Information:**

Name of the Organization : ________________

Form of the Organization : LLP ☐ OPC ☐

Area of Operation : Local ☐ Inter-District ☐ Inter-state ☐ International ☐

Name of the Partner(s)/Member(s) : ________________

Contact No. : ________________

Average Age of Partners/ Members : ________________

Gender (Respondent): : ________________

Educational Background (Respondent) : ________________

Address: : ________________

____

2. Capital Invested

a. First year of business ________________

b. As per last balance sheet ________________

3. Turnover

a. First year of business ________________

b. As per last profit & loss a/c ________________

4. Profit/Loss

a. First year of business ________________

b. As per last profit & loss a/c ________________

5. Debt/Equity Ratio

a. First year of business ________________

b. As per last balance sheet ________________

6. Number of employees in the organization:

a. First year: ________________

b. Last financial year ________________

7. Do you know that management accounting information may be used to make business decisions?

Yes ☐ No ☐

If yes, please specify any technique ______________________________

____

Appendix (Cont.)

8. Have you used any management accounting technique in your business?

   Yes ☐ No ☐

   If yes, please specify any method used recently:

   ____

   ____

9. Is current business your first business under LLP/OPC?

   Yes ☐ No ☐

10. Do you agree that use of management accounting is useful in decision making?

    Strongly Agree ☐

    Agree ☐

    Not Sure ☐

    Disagree ☐

    Strongly Disagree ☐

11. In case you had taken any business decision without the use of management accounting, have you ever regretted that you should have used management accounting?

    Yes ☐ No ☐

    Any specific incidence ____

12. Was it the concept of LLP/OPC that provided you the intention to become an entrepreneur?

    Yes ☐ No ☐

13. Do you or your partner/other member (s) possess any financial/accounting expertise?

    Yes ☐ No ☐

14. Would you like to avail services of professionals/experts in accounting for decision making?

    Yes ☐ No ☐

    a. If yes: Do you find it useful? ____________________________________

    b. If no, why? ____

15. Did you benefit from usage of financial/management accounting information?

    Yes ☐ No ☐

    If yes, how?

    ____

Appendix (Cont.)

16. Which types of difficulties do you face in financial decision making?

    ____

    ____

17. In the system of LLP/OPC, are you afraid of red tapism, problem with public authorities?

    Yes ☐ No ☐

18. Do you find that the incorporated status of your organization is facilitating access to finance?

    Yes ☐ No ☐

19. Do you find that LLPs/OPCs are creating an environment favorable to enterprise creation and growth?

    Yes ☐ No ☐

20. Do you find that LLPs/OPCs are creating entrepreneurial culture and the first generation entrepreneurs?

    Yes ☐ No ☐

21. In the format of LLP/OPC, which source of finance would you like to prefer?

    Formal Source ☐ Informal Source ☐

22. Source of Finance Ratio (Formal to Informal)

    a. First year: ______________________________

    b. Last financial year: ________________________

23. Have you formed this LLP/OPC to protect your personal wealth?

    Yes ☐ No ☐

24. Have you formed this LLP/OPC to facilitate tax planning?

    Yes ☐ No ☐

25. Have you formed this LLP/OPC to raise capital jointly with your partners/other members?

    Yes ☐ No ☐

26. Do you find any marginal benefit of doing business in organized form over the unorganized form?

    Yes ☐ No ☐

27. What are the problems being faced by you in managing your organization?

    ____

    ____

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