Accounting outsourcing among small and medium Enterprises in Batangas City

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ABSTRACT
Outsourcing accounting functions among small and medium enterprises (SMEs) is the focus of this study. The study primarily aimed to discuss outsourcing of accounting services by small and medium enterprises (SMEs). The objectives of this study included determining the profile of SMEs that outsource accounting services in terms of types of industry, forms of business organization, and length of existence, identifying the accounting functions which are most outsourced, discussing the qualifications consider in choosing a provider, identifying the problems encountered on outsourcing, testing if there is significant difference on the problems encountered by SMEs when grouped according to profile of the business and propose an action to address the problems encountered by SMEs.

Majority of the SMEs in Batangas City have existed for one to two years, under manufacturing industry, have 100 to 199 employees and were formed as corporations. Financial reporting is the most common function outsourced by SMEs in the city. Managers of these SMEs consider the level of expertise as the most important qualification a service provider must possess. Most of the problems encountered as to negative effects are criticalness of a function and loss of confidential information, while as to negative decision factors, they usually encounter difficulty in finding a service provider that they can trust and in viewing the activities as core to their businesses. The problems encountered in outsourcing accounting functions are the same among all SMEs in Batangas City.

Keywords: Outsourcing, Accounting Outsourcing, Small and Medium Enterprise, Service provider

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Nowadays, small and medium enterprises (SMEs) are seen as the focal point for growth that will ensure economy in the Philippines to move forward, as well as employment creation and innovation. Given the dynamic and productive characteristics of SMEs, there are resource constraints affecting their performance, development and competitiveness. Small number of people handling and conducting certain functions is one of those resource constraints faced by SMEs. It has been recommended that as organization shift focus towards their core competencies, the presence of outsourcing is an attractive option for business survival in general for them.

Outsourcing is defined as the practice of contracting out business processes to a third party or to an external source. There are many outsourcing services like human resource management, facilities management, accounting, customer support and service, marketing, computer aided design, research, design, content writing, financing and legal documentation. However, the study will focus on outsourcing of accounting services by SMEs (Dorasamy, Marimuthu, Jayabalan,
Raman, Kaliannan, (2010)

Accounting is “the language of business”. Perhaps accounting has an important role in recording and reporting process related to business transactions which is useful for business decision making and performance assessment (Kurniawati, Kurniawan, & Kristian, 2013). The heaviest users of information about SMEs tend to be business owners and managers themselves, seeking information for management purposes. Indeed, good access to information has been shown to help make the most of entrepreneurs’ knowledge and experience and in emerging markets management education is a very strong predictor of SME reporting activity (Ernst & Young, 2011). On the other hand, there are three main problems facing accounting functions in SMEs such as lack of expertise or resources, lack of proper financial records to use as input in decision-making and lack of accounting knowledge and support. Many SMEs do not keep proper financial records and accounts as they are not aware or convinced of the usefulness of accounting and financial reporting requirements for control and decision-making purposes thus they are more likely to outsource their accounting works to accounting firms. As a result, having improved accounting information would permit SME owners to manage their firms better and would allow them to access finance more easily. Companies primarily outsource to avoid certain costs - such as peripheral or "non-core" business expenses, high taxes, excessive government regulation/mandates, and production and/or labor costs. Therefore, some SMEs choose to outsource accounting works relative to utilize a highly paid accountant. The most commonly outsourced services within accounting are payroll accounting, accounts payable, and accounts receivable (Dorasamy et al, 2010).

METHOD

Participants

The participants of this research were the managers of SMEs located within Batangas City with a population of one hundred fifteen (115). The SMEs that participated are composed of businesses that belong in the manufacturing, merchandising or service industry. The researchers asked for a list of registered SMEs from the municipality of Batangas City. Out of 115 respondents, only 65 were able to answer the researchers’ questionnaire. Fifty respondents were unable to answer the questionnaire because of confidentiality of their operation, others didn’t outsource accounting function, other enterprises were using different names not in line to what was registered and others were unable to return the questionnaire.

Materials

The researchers used the descriptive method, with research questionnaires validated and constructed as the major tool of data gathering. Questionnaire is the main instrument used in the conduct of research in order to have sufficient data and information. The researchers prepared the questionnaires used as tools to gather data or necessary information about the extent of implementation on the outsourcing of accounting functions among SMEs. The questionnaire is patterned from the study of Graham Ray last 2009 entitled Finance and Accounting Outsourcing: An Empirical Study of Service Providers.

Procedure

Questionnaires were disseminated and immediate retrieval was made. The researchers then tallied
the data for further statistical treatment followed by the interpretation of tables. Other information related to the study were gathered through personal interview, observation and other source materials to determine the condition or situation arising at the time the study was conducted. After the collection of the questionnaires from the respondents, the responses were posted and presented in tables. The data gathered from the survey were treated by using frequency distribution, weighted mean and analysis of variance to come up with the appropriate analysis.

RESULTS AND DISCUSSION

Table 1 presents the percentage distribution of the respondents’ business profile. One of the factors considered in the study was the number of years businesses were in operation since they were established or existed. Most of them have been in business for a period of 1 to 2 years which comprise of 75.40 percent or 49 businesses. Since they are new in business world, the first thing they want to do is to focus on the operation of their businesses to expand and gain access to new market areas. They intend to give the responsibility of performing accounting functions to external accountants.

Only 2 enterprises or 3.10 percent are operating for about 3 to 5 years since they were established. During these years, in-house accountants may have the knowledge of forecasting the financial status of the company even without the knowledge of other experts.

In terms of the type of industry, most of them are manufacturing businesses with 34 units or 52.30 percent. Manufacturing industries involve lots of processes not only in managing their business but also in their production. Companies work by outsourcing certain noncritical business functions to specialists in order to focus more on their core competencies. Also, when companies outsource, this will help them minimize their investment in human resources and technology thereby, maximize investment in production.

The least among the type of industry are those offering their services which comprise 6 businesses or 9.20 percent. Owners or managers want to assure that all of the accounting records of their branches are properly documented that branch managers of SMEs in Batangas City send their records to main office. The accounting departments of their main offices make their financial statements.

Majority of the businesses in city have 100 to 199 employees which comprise of 56.90 percent. One of the objectives of SMEs is to cut their expenses to expect large earnings. More employees mean large expenses. Instead of having more people, they give the responsibility of accounting functions to external accountants. Since those businesses have few employees, having an in-house accountant cannot harm the earnings and performance of the business. Having few employees can mean that the business has also few workload. Instead of outsourcing accounting functions, they hire an internal accountant who will always be present in the work area (Hafeez, 2014).

The distribution of respondents according to the form of business organization reveals that most of them are corporation consisting of 43 enterprises or 66.10 percent. In putting up a corporation, there are lots of documents and reports they need to prepare. Managers want to assure that the reports are properly made. There is only one partnership or 1.50 percent that outsource according
to the survey. Only few people form partnerships. There are difficulties associated with partnership formation. One of the most obvious disadvantages of partnership is the danger of disagreements between the partners. People are likely to have different ideas on how the business should be run, and who should be doing a particular function. Another disadvantage is that partners share the profits equally. This can lead to inconsistency where one or more partners aren’t putting a fair share of effort into the running or management of the business, but still reaping same rewards.

Table 2 presents the accounting functions commonly outsourced by some businesses in the city. Most SMEs outsource accounting activities because managers want to save more time, effort, and manpower. They can also focus more in their core activities.

Among the activities commonly outsourced, financial reporting ranked first with the highest mean score of 3.12. One reason why businesses outsource the financial reporting function is to follow laws covering the enterprises. According to Flatworld Solutions Company (2014), with financial reporting outsourcing, management makes informed business decision with professional reports, make fast, accurate services and get cost-effective and high-quality services.

Following the financial reporting function is the bookkeeping function. The ease of hiring an outside party to record daily transactions is a great benefit for businesses. Most companies outsource their bookkeeping activities because of its cost effectiveness, the expertise that could be achieved at a comparatively lower payment and its accuracy. Businesses could also have consistent reconciliation, backup for the enterprises’ accounting information, allows business to focus on core business and prevent fraud (Growth Force, 2015).

However, some SMES do not agree to outsource on payroll with mean score of 2.25, respectively. The payroll function is a debt account of the enterprise to their suppliers, creditors, personnel and employees. Companies consider this function as core to their organizations and thus, are handled by their own management.

Payroll refers to the amount paid to employees for services they provided during a certain period of time. While outsourcing payroll saves business time it would otherwise spend calculating pay and deductions and remitting checks to employees and taxation authorities, an outsourcing provider that has never dealt with unique aspects of a company’s payroll, such as unionization and restaurant employee tips, can introduce errors into the payroll unknowingly, and undoing the mistakes can be costly and an administrative headache. According Catherine Loveringto (2013), a payroll company that does not have an interface that allows businesses to enter their employees' hours directly -- and therefore requires the provider to input the information -- can introduce mistakes in pay through simple human error.

Table 3 presents the qualifications of service provider on outsourcing accounting functions. As seen from the table, level of expertise was rated highest by the respondents having a weighted mean of 3.45. This implies level of expertise was the most important when choosing an accounting service provider among them. Outsourcing improves internal quality through expert knowledge and experience of the available external resources. Accounting functions require not only knowledge on generally accepted accounting principles and tax regulation but also the expertise needed to apply the rules in a given business environment. (Evaraert, Sarens, & Rommel,
On the other hand, testimonials from other business received the lowest response having a weighted mean of 3.08, indicating this criterion was less important from others. Even a good review could not give so much importance when choosing service provider due to the competitive pressures at present. Smaller firms are forced to obtain external resource for survival and development (Gooderham, Tobiassen, Doving & Nordhaug, 2004). In fact, intensifying competitive pressures have forced smaller firms to cut costs, and outsourcing is the best method for achieving those goals.

Table 4.1 shows the problems that the respondents encounter in outsourcing accounting functions to service providers with the overall composite mean of 2.66 which indicate that the SMEs agree that the enumerated problems are risks in outsourcing. The items yield average means ranging from 2.57 to 2.71 which implies that there were significant problems in outsourcing among SMEs in Batangas City.

The top two problems, criticalness of a function and loss of confidential information, both with a weighted mean of 2.71, are alike in a manner that they do not depend on the technical performance of the service provider but on the ethical behavior expected of them.

Businesses in the city might be diligent in considering and screening which accounting functions could be trusted in the hands of service providers and which are too critical that they need to be done by the management but according to Locke (2013), when you outsource, you are placing your critical infrastructure in the hands of experts who are able to leverage their knowledge and resources at a large scale to provide better, more reliable service to your business as a reasonable price.

Loss of control and flexibility (2.57) ranked as fifth problem in outsourcing. In outsourcing, business entities pass the work to the service providers, making their level of control limited. Unlike in-house accountants, service providers cannot be directly monitored and controlled by the management because they are independent firms. As stated in Intetics (2013), loss of visibility and control is a common fear because communication is limited and the management becomes far removed from the people who actually do the work.

Table 4.2 presents the problems encountered by SMEs as to negative decision factors. It can be seen from the table that the respondents agree that the enumerated problems are reasons why they do not outsource activities with a composite mean of 2.67. All items registered an average means ranging 2.42-2.82.

The activities being viewed as core to the business and the difficulty to find service providers to trust, both with a weighted mean of 2.82, were ranked highest as problems that cause them not to outsource certain activities.

From this data, one may presume that the primary reasons why SMEs do not outsource are because some of the activities are core to their business and they believe that it will be more efficient if they will do the work instead of outsiders. As stated by Tiunov (2011), core activities are the
essential, defining activities of an organization. If the organization gave those activities to an external party, it would be creating a competitor or dissolving itself.

The findings show that the expensive cost of outsourcing (2.49) is not a significant decision factor. This shows that SMEs are willing to spend on outsourcing regardless of cost. The real value that outsourcing must bring to the company is not lower cost but higher reliability.

Furthermore, the results also indicate that the resistance by existing staff (2.42) is not a barrier in accounting outsourcing. This means that the management has the final decision regarding the buying of services or performing of the accounting functions and opinion of staff and employees do not greatly influence the decision of the management to outsource.

Table 5.1 shows the differences of responses on the problems encountered by SMEs when grouped according to number of years of existence. Based from the result, all computed F-values were all less than the critical values and the resulted p-values of 0.959 and 0.682 were all greater than 0.05 level of significance, thus the researchers fail to reject the null hypothesis of no significant difference on the problems encountered by SMEs in outsourcing of accounting functions when grouped according to number of years of business existence. This implies that no difference exists and indicates that whether the business is new, they experienced the same problems.

SME managers and owners are very cautious most likely in accounting function which serves as a great tool for every business in making decision with quality, and control in all times. The competitive environment, present situation of business, suggests SMEs to have corporate strategy by outsourcing accounting functions. Outsourcing of non-traditional functions increases at the same time as an enterprise adopts a strategy to outsource non-core functions. In effect, this argument that firms laying emphasis on a strategy to outsource non-core activities are likely to increase greater experience and competencies in managing the risks of outsourcing (Devi & Kamyabi, 2011).

Moreover, the business existence is not also significant when SMES encountered the negative effects of outsourcing. Outsourcing can expose an organization to potential risks and legal exposure. Depending upon services outsourced the business will need to provide different information to the outsourcing company. Hence transferring such function to an external accountant or an accounting firm can always be a problem to SMEs when outsourcing at all times whether it is newly established or have been in the industry for so long.

Table 5.2 shows that there is no significant difference on the problems encountered by SMEs when grouped according to industry of business. The result establishes that all computed F-values were all less than the critical values and the resulted p-values of 0.819 and 0.657 were all greater than 0.05 level of significance. This means that the researchers fail to reject the null hypothesis of no significant difference on the problems encountered by SMEs in outsourcing accounting functions when grouped according to industry of business. This indicates that whatever is the industry of business, they experienced the same problems.

Despite the differences among SMEs, they have similarities as to the accounting services they outsource and the risks from outsourcing barely differ from each other. Whether it may be from
manufacturing, merchandising, or service industry, SMEs in Batangas City mostly have the same experiences as to the negative effects that outsourcing have brought about. Same is true for the negative decision factors they consider as to why they do not outsource several of their accounting functions.

Table 5.3 reflects that the computed F-values were less than critical values and the resulted p-values were 0.589 and 0.483. Therefore, with these results, the null hypothesis of no significant difference on the problems encountered by SMEs is accepted. This means that business with lots of employees and those with less experience the same kind of problems.

Outsourcing is “hiring an outside company to handle all or part of an organization’s data processing activities” (Ray, 2009). Some businesses, whether with many or few employees, they outsource to get benefits. The number of employees employed is not much related to the outsourcing decision factor and thus not significantly associated with the problems encountered by SMEs.

One of the reasons why firms outsource is to develop internal staff. One-time projects might need to be undertaken that requires skills that not all employees possess. This just shows that though a company might have a large number of operational employees, it might lack those in the other departments of the business (Bucki, 2014).

It can be seen on Table 5.4 that there is no significant difference on the problems encountered when grouped according to form of business organization. The result shows that all computed F-values were all less than the critical values and the resulted p-values of 0.677 and 0.736 were all greater than 0.05 level of significance. This means that the researchers fail to reject the null hypothesis of no significant difference on the problems encountered by SMEs in outsourcing accounting functions when grouped according to form of business organization. This means that they experience the same problems though with different formation.

Since all businesses, whatever is the type of business organization, wants their businesses to continue operating and generate more profit, they tend to outsource accounting functions due to lack of expertise of in-house accountants. In most jurisdictions, the law requires all or many of the SMEs to prepare financial statements and, often, to have them audited. Normally, the financial statements are filed with the government, posted on a website or are made available on request (European Commision, 2009).
REFERENCES


