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Small Business: Problems and Opportunities for Accounting Firms

By David H. Gobeli and Mary Alice Seville

Upon being complimented on a neatly maintained set of books, a small business owner responded, "My CPA loves them at tax time, but there isn't any information there that I can actually use to manage my business." The firm went out of business shortly afterwards, in part due to poor information and consequent confusion about actual costs. Poor cost information led to inaccurate bids for contracts, which in turn hurt profitability.

Unfortunately, this is not an isolated incident. Nationwide there is an alarming rate of small business failures each year which can ultimately be traced to ineffective management. Various specific causes can contribute to this problem, but one root cause is a lack of good management information — especially financial information — as explained by DeThomas and Fredenberger [1985]. Larson and Clute [1979] present a similar perspective as they describe the "failure syndrome" that is fueled, at least in part, by a critical unmet need for usable accounting information.

Where do small businesses turn for help to improve management information and avoid the failure syndrome? Arnold et al [1984] found that the CPA is considered the primary external adviser. Unfortunately, only 25% of 500 small businesses studied view that external adviser as very important in meeting management needs.

Small businesses need help, but there appears to be a gap between what is needed and what is available from accounting firms. Are accounting firms interested in better serving the small business? The answer is a resounding "yes!" according to Donna Sammons [1984]. Several CPAs interviewed as part of this study confirm a strong interest in better serving small businesses, even going beyond their traditional tax planning and preparation roles.

This article is based on a study of 148 small businesses. It was sponsored by the Benton-Linn chapter of the Oregon Society of CPAs, the Small Business Administra-

tion through the Small Business Institute Program at Oregon State University, and the Oregon Productivity and Technology Center. The CPAs provided valuable assistance in selecting questions and a wide representation of industries in their client bases. This means, of course, that the results are biased toward industries already using CPAs.

The Approach

This study was initiated as a result of experiences with over 150 small businesses participating in the Small Business Institute (SBI) Program. A frequent complaint was the poor quality of business information. The authors, both faculty participants in the program, began to wonder how well the accounting profession was actually serving small businesses. To find out, two MBA students performed 40 telephone interviews with randomly selected businesses in Corvallis, Oregon — a typical university town.

The interviews provided many insights but raised other questions, so the questionnaire was further refined for personal interviews in 148 businesses in five industries: hardware stores, optometrists, restaurants, general contractors, and grass seed farmers.

The personal interviews covered representative small businesses throughout the northwest portion of Oregon. Approximately 80% of the businesses had been in business more than five years, although the restaurants tended to be "young" with almost half having been in business less than five years. Sole proprietorship (44%) and corporations (40%) were the most popular forms of ownership. The majority of businesses had five or fewer employees; only 20 of them had more than 20 employees; and the largest had 85 employees. All were independently owned and

The research was supported jointly by the Oregon Society of CPAs and the Oregon Productivity and Technology Center of Oregon State University.

operated. No franchises were included. The interviewee was most often the owner-manager (about two-thirds of the interviews). All businesses rated themselves as average or better in level of success.

The Accountant - Small Business Relationship

First to be explored is how small businesses use accounting services. Ninety percent of the businesses used an outside accounting service for some purpose, and 79% of those used a CPA firm as that outside service. To further examine the accountant-small business relationship, information on the following items was gathered: why they were not using CPAs, how long they had used their current service, and how knowledgeable they believed accountants to be.

Reasons

The major reason for not using a CPA was that the CPA was perceived to be not as knowledgeable as others. The second most common reason was cost. These factors and the belief that "an employee can do it as well" combined to explain most of the lack of interest in using CPAs. There was a slightly greater tendency to use a CPA firm only for tax preparation (79%) than to use other types of outside accounting services only for tax preparation (74%).

Tenure

Forty-one percent of the businesses had used their current bookkeeping/accounting service for five years or less. There were, of course, some businesses that had used the same firm for as long as they had been in business, but 59% had used more than one bookkeeping/accounting firm. A primary reason for switching accounting firms was to find an accountant more knowledgeable about the industry. The two other major reasons for switching were unsatisfactory service (personality conflicts, poor communication, etc.) and an accounting service or accountant that was no longer available.

Knowledgeability

Most of the businesses were satisfied with their current account-

ing firm's knowledge of their business. All industries gave accountants a rating of 2.5 or higher on a 4.0 scale.¹ Grass seed farmers and optometrists perceived their outside services to be more knowledgeable than the other industries. Contrary to some popular beliefs, most businesses believed their accountants gave them very clear (3.0) explanations.

The pattern seems to be that the small business owner switches firms until one the "fits" is found. The next two sections discuss how accountants could expand their service to small businesses and provide a better fit so this relationship can be further developed.

Utility of Accounting Information Items

This research study shows there are definitely opportunities to extend current accounting services. To investigate these opportunities, the research reviewed the types of information managers actually use, the utility of different types of accounting information, the critical factors a business should monitor, and the form in which information on these factors is collected.

Information

To determine opportunities, a starting point is the kind of information, accounting and other, that business owner/managers actually use. Figure 1 presents the results from asking if a specific type of accounting information was used for either external or internal purposes, and if the business owner/manager found it not useful (1.0), somewhat useful (2.0), very useful (3.0), or extremely useful (4.0) in managing the business. The dashed line shows how useful the item is (e.g., cash flows are rated very useful with a 3.0 average rating). The solid line shows the proportion that used each information item (e.g., 55% use cash flow information). The apparent contradiction of people using information that they do not consider useful is easily reconciled; information may be used for statutory purposes (tax returns) or borrowing

¹The respondent was asked if the accounting service was not at all knowledgeable (1.0), somewhat (2.0), very (3.0), or extremely knowledgeable (4.0) about the business.

(financial statements) without being useful for management purposes.

The results presented in Figure 1 are interesting for another reason. The fact that financial statements and tax returns are used, but for the most part are not useful for managing a business, may indicate why clients tend to complain about fees. They are receiving information that is important for limited purposes but does not help them run the business. Education and marketing are needed to correct this situation; small business people need to know that accountants can help them, 1), get information that is truly useful in their business and, 2), use the information they are getting. Chances are they would be willing to pay for the improved service.

Critical Factors

The business manager/owners were asked to name the three critical factors about their business that they must monitor. Table 1 presents those results. The variability among industries is interesting. While "monitoring costs" was the most frequently mentioned factor for the group as a whole, it was not mentioned by hardware stores. Hardware stores were most concerned about inventory control, yet inventory control was mentioned by only a few other businesses. Thus, information must be tailored to the business.

The list of critical factors, while interesting, should not be considered definitive. The approach is more important than the end result. If the accountant will listen to the small business owner/manager, the accountant can fit the information to the business.

Form

Would the business owner/manager use the information if it were provided? To answer this, the question, "In what form does the information to monitor the critical factors get to you?" was asked. The results are presented in Table 2. The heavy reliance on "observation/experience" and "verbal" are indications of the old problem of getting people to pay attention to the written reports they are given.

Many opportunities exist, but educating the client on the content of

written reports and the benefits of that information is very important. Accountants need to build up credibility for these new services.

Perceptions About Business Needs and CPA Qualifications

To explore the opportunity for added services, the small business owner/managers were asked a series of questions to see what specific business services were needed and, whether needed or not, if CPAs were perceived as not qualified (1.0), somewhat qualified (2.0), very qualified (3.0), or extremely qualified (4.0) to provide it. The results are summarized in Figure 2. The solid bar shows the proportion needing each of the nine services (e.g., 86% need financial statements). The hatched bar presents the perceptions of CPA qualifications to provide the service (e.g., CPAs were rated an average of 3.4, between very and extremely qualified, for financial statement preparation). The figure indicates the magnitude of the opportunity for CPAs. A hatched bar that is low for a business service means that clients, current and prospective, do not think of CPAs when they need that service. This is definitely the case for New Venture Planning, Computer Systems, Business Consulting, Business Planning, and Marketing Planning. More surprisingly, there is even some doubt about the qualifications of CPAs to do Financial Planning and Tax Planning. If CPAs really are qualified to provide these services, there is a need for education and marketing to acquaint small business owner/managers with the possibilities. Of course, the most promising services to pursue are the ones needed by a high percentage of the businesses (the solid bar is long).

The services CPAs are perceived as most qualified to provide are, of course, Financial Statement Preparation and Tax Return Preparation. As we saw above, however, financial statements and tax returns do not have a lot of utility in management decision making. We also asked what other types of services CPAs are perceived as qualified to provide. While investment consulting and estate planning were mentioned most frequently, bankruptcy planning, retirement plans, financial analysis,

	OPTOMETRY	HARDWARE	SEED FARM	GEN. CONT.	RESTAURANTS	TOTAL
Costs	13	0	12	22	32	79
Personnel	8	10	0	8	10	36
Customer Service/ Quality	7	8	0	11	7	33
Cash Flow	8	12	4	6	2	32
Inventory	6	22	0	0	1	29
Sales Volume	9	11	0	0	3	23
Profit	5	7	8	1	1	22
Environment*	0	0	12	3	7	22
Marketing/Advertising	2	3	7	8	0	20

*Weather, economy, location, competition, regulations

	OPTOMETRY	HARDWARE	SEED FARM	GEN. CONT.	RESTAURANTS	TOTAL
Observation/ Experience	0	32	5	26	25	88
Printed Summary	26	16	12	21	13	88
Verbal	11	4	30	11	30	86
Printed with detail	15	14	12	5	18	64
Computer	3	17	2	4	5	31

NATURE OF LESSON	DESCRIPTION OF LESSON
Relevance	When designing an information system, start with the factors the small business owner/manager tells you are most critical to the business's success.
Utility	Emphasize cash flow, job cost, and inventory control information since they are more useful than the traditional statements.
Multiple Uses	Design the system to get tax information and provide useful management information at the same time.
Convenience	Since the owner/manager is going to be one of the primary people collecting and entering the data, make it quick and easy to use.
Understanding	Obtain a good understanding of the industry and the particular business.
Competence	Master and then demonstrate that CPAs are qualified to provide other services. Otherwise, do not offer them.
Opportunity	Learn and communicate skills in financial planning, tax planning, business consulting, computer system design, and business planning.

form of business, projections, management analysis, business trends, and moral support were also mentioned.

Conclusion

CPAs are viewed by many small business owner/managers as pre-

parers of tax returns and financial statements. Assuming the CPAs want and deserve a broader image, the results of this research provide several messages for CPAs and other accountants (summarized in Table 3).

Figure 1
Utility of Accounting Information

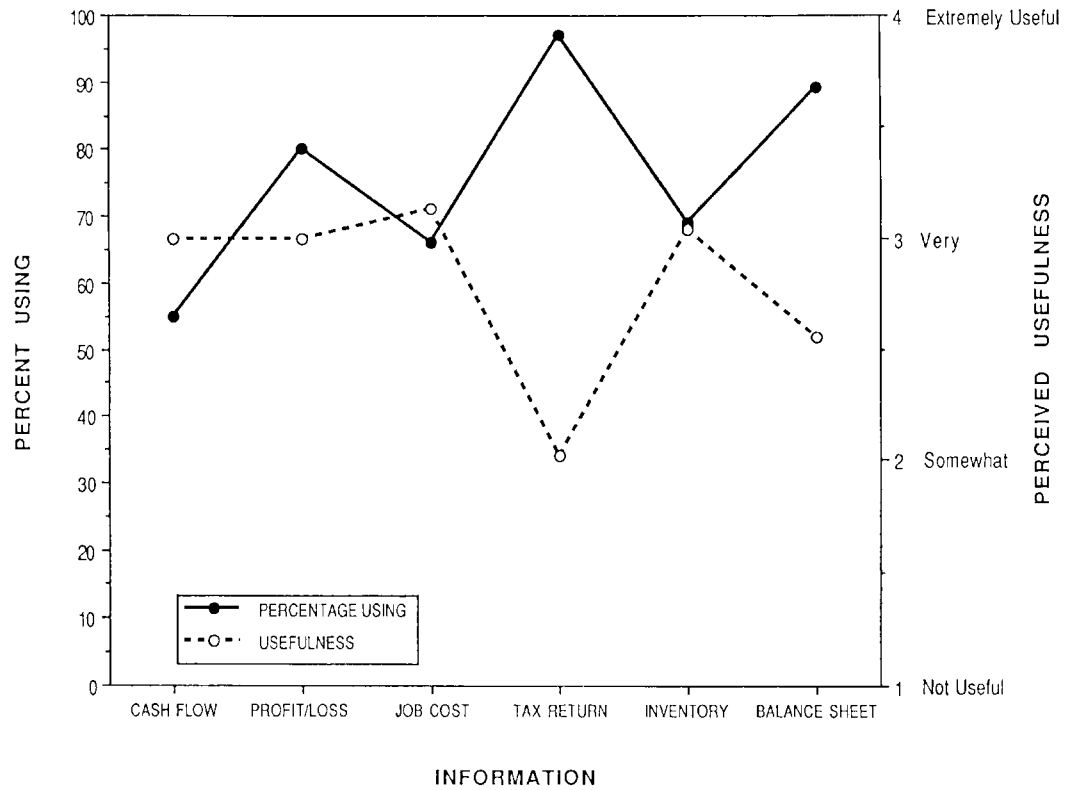
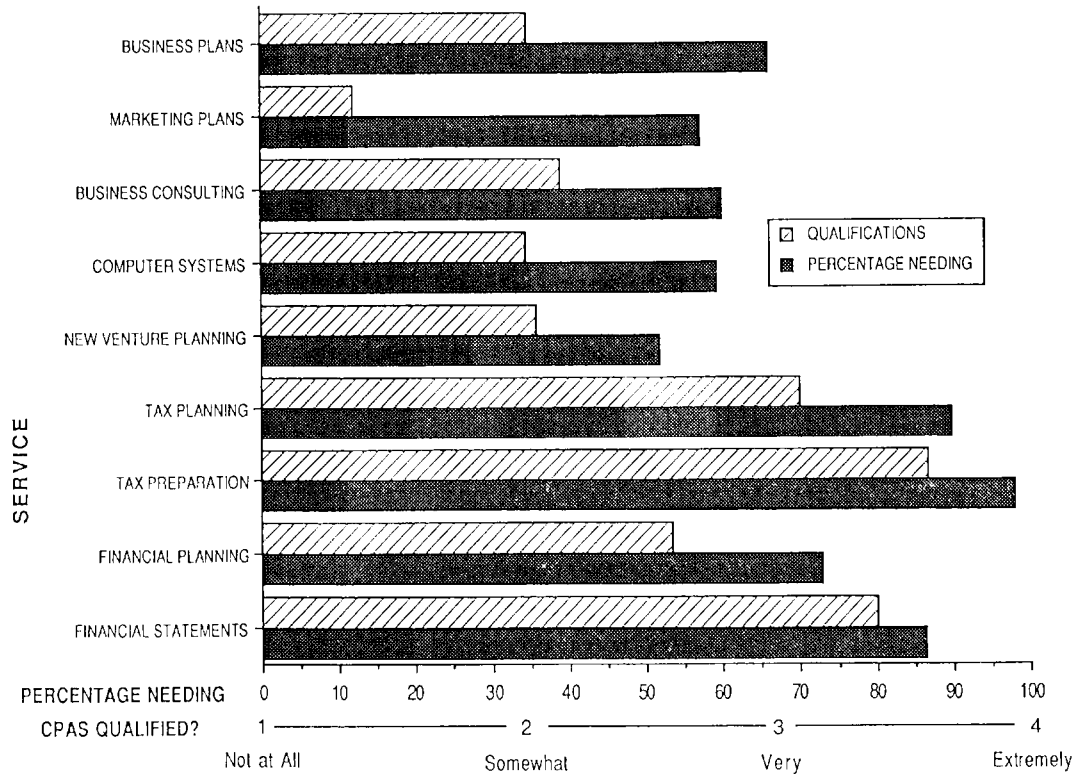


Figure 2
Service Needs and Perceptions of CPA Qualifications



Relevance

Owner/managers know the factors critical to success and can easily verbalize them. If the accountant starts with a dialogue about those critical factors when developing an information system designed for the business, the owner/manager will get the most critical information. Also, managers will be more "likely to buy into" and use the system if they have been involved in the process of its design and understand the relationship between needs and the system.

Utility

Some of the information provided by accountants is not useful, and accountants are not perceived as qualified to provide some of the information/services small businesses believe they need. Accountants are viewed primarily as preparers of financial statements and tax returns by small business owner/managers. Tax returns are seen as necessary but almost useless for management information. For financial statements, the profit and loss statement is seen as much more useful than a balance sheet. Other accounting information — cash flow, job cost, and inventory control — is viewed as useful as, or more useful than, the profit and loss statement. If accountants are going to provide useful information, they need to go beyond traditional financial statements.

Multiple Uses

Many businesses have an information system in place to gather tax information. If that system can be expanded to gather useful management information, the small business will benefit. Small businesses uniformly recognize a need for tax planning, but they perceive CPAs as less qualified to provide that service than to prepare tax returns.

Convenience

The small business owner/manager is probably involved in data gathering if not serving as the primary gatherer. The information system should be easy to use so the process is not burdensome. If the information system is too complex, it will not be used.

Understanding

In order to serve the small business effectively, the accountant needs to understand the industry and the particular business. Small business owners tend to switch accounting firms until they find one they are comfortable with. One of the primary reasons cited for switching is that the accountant was not knowledgeable about the industry.

Competence

Small business owner/managers need more than traditional accounting services, but they do not perceive CPAs as qualified to provide services such as Financial Planning, Business Consulting, Business Planning, Computer Systems, New Venture Planning, and Marketing Planning. While not every CPA will want to provide all of the mentioned services, we believe some CPAs — with proper preparation — could expand into these areas.

Opportunity

The last lesson is that the foregoing spells opportunity for accounting firms. The gap between current services and small business needs is real, as are the opportunities for more services.

Small businesses do indeed represent opportunities for accountants. Accountants can explore several avenues to expand or add services for small businesses. The problem is that small business owner/managers do not realize accountants are qualified to provide many of the services needed, or they do not recognize the benefits of the information provided. Compounding this situation is a failure of accountants to fit the information to real needs.

Accountants, individually and collectively, can help by speaking to business groups, preparing pamphlets describing what services accountants can provide, and participating in SBA workshops. Above all, however, the CPA should suggest new services to clients in the context of benefits for the business.

Community colleges and universities can also be major players by demonstrating to future accountants how they should work with small businesses. On the other hand, they

can also train future small business owner/managers to work with accountants in order to ensure that useful information is provided.

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