The Theoretical Link Between Cash Flow Statement Usage and Decision Making In South African Small, Medium and Micro Enterprises

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Abstract

South African Small, Medium and Micro Enterprises (SMMEs) are of great importance to the national economy due to their socio-economic value-adding abilities. Despite being responsible for contributing generously to the national Gross Domestic Product (GDP) and providing employment opportunities to more than half of the national workforce, research shows that up to 80% of these business entities fail after being in operation for three years. The latter dispensation is often blamed on unmanaged economic factors and subsequent risks; including that of poor cash flow management. To assess the cash flow situation of a business entity, a cash flow statement is generally used. According to academic literature, South African SMMEs do not make adequate use of cash flow statements which, in turn, may have negative repercussions on business decision making within South African SMMEs. The inadequate use of cash flow statements can be attributable to the isomorphic changes which these business entities undergo, particularly mimetic isomorphism. Therefore, the primary research objective of this study was to determine whether South African SMMEs' limited utilisation of cash flow statements, as brought about by mimetic isomorphism, has an adverse influence on their business decision making in a theoretical dispensation. This study was non-empirical and qualitative and made use of an online desktop review approach by scrutinising secondary data to, in turn, develop propositions for further empirical testing. From the research conducted it appears that South African SMMEs' limited utilisation of cash flow statements may adversely influence business decision making within these business entities, at least in a theoretical sense.

Keywords: SMMEs, South Africa, Business Decision Making, Cash Flow Statement, Cash Flow.

1. INTRODUCTION

According to the *National Small Business Act No. 102 of 1996*, South African Small, Medium and Micro Enterprises (SMMEs) are defined as separate small and distinct business entities that are owned and/or managed by one or more owner(s) that conduct their business in any sector and/or sub-sector that is relevant to the national economy [1, 2, 3]. Since their formal recognition by the national government, in 1996, South African SMMEs have been subsequently promoted to assist in the attainment of three core socio-economic objectives, namely: 1) job creation, 2) poverty alleviation and 3) equal wealth dissemination [4, 5]. Over the years, the number of these business entities have grown to such an extent that 98% of all South African business entities in operation are regarded as SMMEs [6]. Hence, it is not surprising that South African SMMEs have been reported to contribute 50% to the Gross Domestic Product (GDP) while also providing 60% of all employment opportunities to the total South African workforce [4, 7].

Despite the socio-economic contributions made by South African SMMEs to the national economy, as well as the support provided to these business entities by the national government[1], research suggests that these business entities have among the highest failure rates in the world [8, 9]. During the early-2010s, it was reported that 40% of newly established SMMEs fail in their first year of operation, 60% in their second year of operation, and 90% in their first 10 years of operation [10, 11]. In more recent times, however, research suggests that between 70% and 80% of South African SMMEs fail within the first three years of their existence [10, 12, 86]. More often than not, the blame for the high South African SMME failure rate is shifted on the non-management of economic factors and related risks in a non-conducive economic environment [13, 14, 64]. Examples of the latter include, among others, the lack of basic business skills, poor management skills, increases in taxation, fluctuations in supply and demand, excessive red tape, high unemployment rates and high inflation rates [15, 16, 17, 18, 39]. Another critical reason why SMMEs fail is due to poor cash flow management [65].

The phenomenon of cash flow management has to do with the planning, leading, organising and controlling of money that both enter and leave a business entity [19, 20]. Taking into account that money is the lifeblood of any business entity, it becomes ostensible as to why economic, efficient and effective cash flow management practices were found to positively contribute towards business sustainability [21, 22, 23, 24]. One manner in which proper cash flow management can be executed is through the use of financial performance measurement tools, one of which is the cash flow statement.

The cash flow statement provides an overview surrounding the cash-on-hand situation of a business entity concerning its operating activities, investment activities and financing activities [25, 26]. It is also possible that the cash flow statement can be used to assist management to make sound business decisions [27, 28]. Unfortunately, research suggests that South African SMMEs do not properly utilise cash flow statements, as bank statements are primarily consulted when business decisions are made by management [29, 30].

The limited use of the cash flow statement by South African SMMEs can be coupled to the neo-institutional theory – a phenomenon where every business entity strives to become like one

[1] The South African government actively offers support to South African SMMEs through agencies such as inter alia that of the Centre for Small Business Promotion, Ntsika enterprises Promotion Agency and Khula Enterprise Finance company [64].

another while being influenced by similar external forces and undergoing relevant isomorphic changes [69, 70]. Among the isomorphic changes that a business undergoes, as underpinned by the theory, is that of mimetic isomorphism [73, 74, 75]. In layperson's terms, mimetic isomorphism pertains to those changes which a business entity undergoes through copying-and-pasting practices and/or operations from successful business entities, as-is [71, 72].

In fundamental nature, the perception exists that South African SMME management may not necessarily make sound business decisions to fortify and/or improve the sustainability of their relevant business entities, especially where existing practices and/or operations from successful business entities are copied-and-pasted, as-is. This may be why these business entities make limited utilisation of cash flow statements as a decision-making tool. To this end, the area of concern that was researched within the ambit of this paper reads as follows: "*South African SMMEs' limited utilisation of cash flow statements, as possibly spurred on by mimetic isomorphism, may have an adverse influence on relevant business decision making*". As such, the primary objective of this study was to determine whether South African SMMEs' limited utilisation of cash flow statements may, theoretically, adverse influence their relevant business decision making.

To achieve the foregoing, non-empirical research was conducted which took on an online desktop research approach. In quintessence, secondary data were gathered from academic databases through the inclusion of keywords and, subsequently, reviewed [85]. For the sake of transparency, this study was nascent as the primary aim thereof has attracted limited research and/or theorising to date [90, 91]. Therefore, the authors anticipated that since South African SMMEs do not utilise cash flow statements – a financial statement that can assist management in making sound business decisions – it may have a negative influence on relevant business decision making.

2. RESEARCH DESIGN

For this research study, exploratory research was conducted as the emphasis was placed on the discovery of ideas and insights into a theoretical idea [82, 83]. Furthermore, the research topic was nascent as limited research has been conducted on it and/or limited current theorising on it has taken place [90, 91]. For this reason, non-empirical research was conducted, taking on an inductive approach to assist in the development of a theory, stemming from the observation of empirical data [84]. The theory that was developed pertained to South African SMMEs' limited utilisation of cash flow statements and its influence on relevant decision making [22, 53].

In terms of the research methodology, qualitative research was conducted since it entailed the collection and reviewing of secondary data, as collected and analysed by other researchers [85]. In particular, an online desktop research approach was followed as secondary data were gathered from sources such as libraries, journals and websites after which they were reviewed [81]. Two major inherent limitations of online desktop research include that of author subjectivity and secondary data scope [31]. For the sake of transparency, the authors took reasonable steps to mitigate the latter limitations by first searching for secondary data containing keywords which included: "cash flow", "cash flow statement", "financial statement", "SMME", "sustainability", and "South Africa". Specifically, these keywords were searched for in a South African SMME dispensation as far as possible. Throughout the authors ensured that strong statements were supported by more than one secondary source.

The two main reasons as to why an online desktop research approach was selected over a literature review approach are that this study was exploratory and that the topic was nascent. In fundamental nature, the authors wanted to establish a foundation for future empirical research. To achieve this, reputable secondary sources were collected and reviewed which enabled the authors to both conceptualise and contextualise relevant terminology, while also allowing for the achievement of the primary research objective.

3. LITERATURE REVIEW

3.1 The neo-institutional Theory

The neo-institutional theory, initially dubbed *institutional isomorphism*, was developed by Paul DiMaggio and Walter Powell during the early-1980s through analysing institutional processes and institutional forces [68]. This theory was developed from the observation that although every business entity is unique, all business entities eventually strive to become similar to one another as they undergo isomorphic change, while simultaneously being influenced by similar external forces [69, 70]. Generally, these external forces pertain to three aspects, namely: 1) coercive isomorphism (forces which stem from other organisations on which the business is dependent, for example, government agencies and legislation), 2) mimetic isomorphism (forces which stem from uncertainty, for example, trends set by competitors and popular tools used by successful organisations), and 3) normative isomorphism (forces which stem from professional organisations, for example, lawyers, accountants, and medical professionals) [71, 72].

Since its initial development, to date, the neo-institutional theory has proven to be highly relevant and valid. The latter sentiment is supported by studies where this theory was used to assist in the conducting of research applicable to crowdfunding initiatives, corporate social responsibility, and governance [73, 74, 75]. Notwithstanding the latter, it is therefore not surprising that prior research shows that business decisions made by management, which affect how business objectives are achieved, are influenced by mimetic isomorphism which, in turn, comprises: 1) frequency-based imitation (modal trends), 2) trait-based imitation (popular trends), and 3) outcome-based imitation (new and/or successful trends) [87].

When practices and/or operations are copied-and-pasted from successful business entities to a small business, it does not guarantee the attainment of business objectives in the foreseeable future [76]. This is particularly the case since every business is a clear and vivid reflection of its management – what works well in one business does not necessarily guarantee similar results when used directly in another business [92]. Alternatively stated, business entities that undergo mimetic isomorphism generally skip “trial-and-error practices” by copying-and-pasting tried-and-tested practices that were customised for a particular business entity with unique business objectives [77].

Within the ambit of this study, while using the above as a basis, it becomes apparent that small businesses may imitate a popular trend – e.g. to not use cash flow statements – despite its potential adverse influence on the attainment of relevant business objectives. In other words, customisation is key; what works in one successful business entity is not guaranteed to work in another business entity [88].

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3.2 South African SMME Sustainability

Various definitions exist for the term “sustainability”. For the sake of this study, the term “sustainability” is defined from an accounting perspective as the ability of a business entity to achieve its economic objectives (e.g. profitability, solvency and liquidity), social objectives (e.g. e.g. community building and charity) and/or environmental objectives (e.g. minimising wastage and minimising carbon footprints) in the foreseeable future [64, 66, 93]. In quintessence, sustainability, within the ambit of this study, is synonymous with the triple bottom line – a business needs to take responsibility for its people (its stakeholders), its planet (the environments which it affects), and its profit (the attainment of economic objectives) [12, 32, 33, 34, 67].

When taking into account that business operations cannot continue to take place without first achieving its relevant economic objectives [12], the inference can be made that the attainment of economic objectives is more important than the attainment of any other objectives, especially in a small business dispensation. For this reason, it is fair to assume that the “weak sustainability rate” of South African SMMEs pertain to how these business entities fail to achieve their economic objectives.

Despite receiving support from the national government since 1996, South African SMMEs still have significant sustainability issues. During the early-2000s it was reported that 70% of South African SMMEs failed within their first three years of existence [35]. Closer to the early 2010s, research found that 75% of these business entities were failing after being in operation for only three years [36]. Closer to 2020, the reported failure rate of South African SMMEs was unchangeable – regarded to be among the worst failure rates in the world [37, 38, 40]. For this reason, the inference can be made that the [economic] sustainability of South African SMMEs has not significantly improved over more than two decades.

The prevailing factors that are blamed for contributing to the weak SMME [economic] sustainability are largely the same today than what it was during the early-2000, which include *inter alia* insufficient product demand, high labour turnover, excessive government regulations, high interest rates, stiff competition, high crime levels, high unemployment and unreliable supply of water and electricity [39]. Notwithstanding the above, another prevailing factor that is believed to contribute to the high failure rate of South African SMMEs is that of poor cash management, which leads to poor business decision making; ultimately affecting the existence of a business entity [78, 58].

Considering the phenomenon of mimetic isomorphism, it may be that South African SMMEs mimic an approach(es) to manage risks and/or the addressing of prevailing factors from successful business entities. Taking into account the high failure rate of South African SMMEs, which has not yet improved over more than two decades, it may be that mimetic isomorphism is doing more harm than good; particularly noting the poor cash management of these business entities.

3.3 Cash Management and The Cash Flow Statement

Within the ambit of this study, the term "cash management" is conceptualised as the process of keeping track of the amount of money that enters and leaves a business entity, which can be used to assist in the achievement of relevant business-related objectives in the foreseeable future [41, 42, 43, 44]. Since cash is regarded as the lifeblood of any business entity, the inference can be made that a business entity's management should be financially literate [45]. In layperson's terms, this means that a business' management should possess the ability to make informed and effective business decisions while taking into account the proper use and management of a business entity's cash [26].

To assist relevant stakeholders in the management of cash flow in a business entity, a cash flow statement is generally used. The cash flow statement is a financial statement that, if properly utilised, can provide management with information pertaining to 1) the amount of money received from customers, 2) the money payable to liabilities[2], 3) the net assets[3] that are on hand, and 4) the net investments of a business entity [46]. The cash flow statement is generally demarcated into three categories, namely that of operating activities, financing activities, and investing activities – as summarised below [5, 26, 46, 47, 48]:

- Operating activities: Those business activities, of a cash nature, that relate to the day-to-day cash income and cash expenses. The net effect is calculated by deducting cash expenses from cash income.
- Financing activities: Those business activities that relate to the repayment or acquisition of long- term loans, the issuing of debentures, and/or the issuing of shares. The net effect is calculated by considering the changes made to non-current liabilities and owners' equity.

2 A liability is a present obligation, resulting from the transfer of an economic resource, in the past that cannot be practically avoided [79].

3 An asset is a present economic resource that is controlled by a business entity, resulting from a past event, which has the potential to generate income [80].

- Investing activities: Those business activities surrounding the acquisition of non-current assets, for example, vehicles, property, and/or long-term investments. The net effect is calculated by considering changes in non-current assets (and investments).

In essence, the cash flow statement displays the cash generated and/or utilised in the three aforementioned categories [49, 50]. Moreover, this financial statement adds to the functionality of the "bigger picture" of a business entity's financial performance and financial position by classifying cash inflow and cash outflow [25, 26, 51, 52]. When taking into account that proper cash management favourably contributes towards a business' [economic] sustainability [22, 53, 54] and that the cash flow statement can assist management to make better business decisions [94], the inference can be made that when South African SMMEs make use of the cash flow statement, it should have a positive influence on relevant business decision making.

3.4 Cash Flow Statements and Business Decision Making In South African SMMEs

Notwithstanding the above, prior research suggests that the bulk of these business entities do not make use of poor cash management practices [48, 55, 56]. Otherwise stated, the manner in which South African SMME management manage their business entities' cash flow leaves much to be desired [57, 58]. This view is substantiated by local studies [29, 30, 63] where it was found that management of South African SMMEs predominantly relies on bank statements to make relevant business decisions, despite having access to cash flow statements. This is quite cumbersome as the bank statement does not necessarily take into account all transactions gone on by a business entity; does not consider real-time liquidity [63].

When business entities utilise financial performance measures, such as the cash flow statement, it should enhance business decision making through emphasising economy, effectiveness and efficiency by providing reliable, timely, relevant and useful information [59, 60, 61]. According to at least one local study, South African SMME sustainability was found to be stifled due to poor decision making stemming from incomplete financial information contained in the bank statement [57]. This can be attributable by the fact that the bank statement – which provides only historic [financial] data – is widely used by South African SMMEs to make business decisions associated with profitability (the ability to make more income than expenses), solvency (the ability to have own more assets than liabilities), liquidity (the ability to have sufficient money on hand to pay creditors), and efficiency (the ability to earn money as quickly as possible) [62, 63, 89]. More often than not, a bank statement only provides information pertaining to cash inflows and cash outflows, in a historic dispensation.

Henceforth, it is highly probable that South African SMME management, as influenced by mimetic isomorphism, choose to use the bank statement as opposed to the cash flow statement to make relevant business decisions. As the failure rate of South African SMMEs has not significantly improved over the span of two decades, it may be that the decision of these business entities to ignore the cash flow statement has a direct negative influence on the achievement of business objectives; relevant business decision making.

4. DISCUSSION

Considering that 98% of all operating South African business entities are SMMEs [6], including the cardinal socio-economic value these enterprises add to the South African economy [4,5], it becomes disconcerting to note the high South African SMME failure rate. Over the past two decades, the failure rate of South African SMMEs has been found to be among the worst in the world [40] - between 70% and 80% of these business entities fail after being in operation for only three years. An array of economic factors have been blamed (and are still blamed) for the latter dispensation, one of which is that of poor cash management [65].

Taking into account the neo-institutional theory, three external forces are highlighted that influence business entities in their pursuit to become sustainable, namely coercive isomorphism, mimetic isomorphism, and normative isomorphism [71, 72]. Though most economic factors are encapsulated in coercive isomorphism and normative isomorphism, the phenomenon of poor cash management may highly likely pertain to mimetic isomorphism [76, 77]. This view is supported by the fact that small business entities tend to copy-and-paste existing practices and/or operations from at least one successful business entity without considering repercussions on its operations [88, 92].

Among the tools (financial statements) which small business management can use to make economic business decisions is that of the cash flow statement – a financial statement that provides clarity on how cash flows in and out of a business entity [5, 26, 46, 47, 48]. In the case of South African SMMEs, although a large proportion of these business entities have access to the cash flow statement, they do not make use of it to make business decisions but rather prefer using the bank statement [29, 63]. Even though the cash flow statement can assist management with better decision making [57, 58, 94] and that it is freely available to small businesses for use [62, 63], since the majority of South African SMMEs make use of bank statements to make business decisions [30], it becomes highly probable that this behaviour is encouraged by mimetic isomorphism – where existing practices and/or operations are merely copied from at least one successful business entity in the hopes of becoming sustainable [69, 70]. In layperson's terms, it may be that the decision of South African SMMEs to ignore the cash flow statement as a financial statement has an adverse influence on their [economic] sustainability. To this end, the following three propositions are provided for further empirical testing:

- Proposition 1: Where South African SMMEs utilise the cash flow statement to make relevant business decisions, it has a statistically significant positive influence on their [economic] sustainability.
- Proposition 2: Where South African SMMEs utilise the cash flow statement to make relevant business decisions, it has no statistically significant influence on their [economic] sustainability.
- Proposition 3: Where South African SMMEs utilise the cash flow statement to make relevant business decisions, it has a statistically significant negative influence on their [economic] sustainability.

Considering that the cash flow statement provides more clarity surrounding the "bigger picture" of a business entity's financial performance and financial position [51, 52] there is a possibility that when South African SMME management makes use of cash flow statements to make relevant business decisions, it may have a positive influence on their [economic] sustainability. The findings made in this study suggests that mimetic isomorphism, in the sense of using bank statements instead of the cash flow statement to make business decisions [87, 88] (*status quo*), should be challenged.

5. CONCLUSION

For this study, the focus was placed on achieving the primary objective of determining whether South African SMMEs' limited utilisation of cash flow statements, as brought on by mimetic isomorphism, has an adverse influence on their business decision making, at least in a theoretical dispensation. This was achieved through adopting an online desktop research approach whereby secondary sources were collected and reviewed to allow for relevant discussions to take place pertaining to the neo-institutional theory, South African SMME sustainability, cash management and the cash flow statement, and cash flow statements and business decision making in South African SMMEs.

Stemming from the research conducted, although most South African SMMEs have access to cash flow statements, almost every South African SMME prefers to use the bank statement to make business decisions. This is disconcerting as it appears that SMMEs are highly susceptible to mimetic isomorphism – these business entities prefer to replicate what other (successful) businesses do (copying-and-pasting their practices and/or operations) as opposed to doing their own thing. Considering that between 70% and 80% of South African SMMEs fail within their first three years of operation, the non-utilisation of cash flow statements, to make business decisions, may actually be a major contributor towards the high failure rate of these business entities. In fundamental nature, from the research conducted, the authors propose that the manner in which South African SMMEs undergo mimetic isomorphism, in relation to using the bank statement to make business decisions as opposed to the cash flow statement, should be challenged in order to facilitate possible new avenues to fortify and/or improve their [economic] sustainability. Although the utilisation of the bank statement as a tried-and-tested practice has worked for many of these business entities, research suggests that better business decisions can be made if the cash flow statement is used on a trial-and-error basis.

For the sake of transparency, considering the limitation of secondary data scope, applicable to online desktop research, the authors reasonably ensured that sufficient secondary data were gathered, from a variety of sources, after which they were reviewed. By doing so, the authors believe that a fair conclusion was reached in relation to the nascent research topic. In addition, the limitation of author subjectivity was also kept to a minimum through the inclusion of as many topic-related secondary data as possible, despite the limited research that has been conducted on the research topic, in a holistic manner.

In terms of practical implications, if the cash flow statement is used by small business management, it can allow for better cash management which, in turn, may have a direct positive influence on the manner in which business decisions are made; possible improvements in their [economic] sustainability.

Using the above as a basis, and apart from the three propositions proposed to be further empirically researched, avenues for further research include, but are not limited to 1) the influence of current cash management processes on the [economic] sustainability of South African SMMEs, 2) the intrinsic effect of cash flow statement usage on South African SMME [economic] sustainability, and 3) the feasibility of using bank statements as a business decision-making tool in South African SMMEs.

6. ACKNOWLEDGEMENTS

The authors of this paper wish to acknowledge Auston Owies who assisted with the preliminary steps of this study.

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