

**Outsourcing of Accounting Functions amongst SME Companies in
Malaysia: An Exploratory Study**

by

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ABSTRACT

The challenges in sustaining a competitive advantage in the corporate world faced by businesses have become a major concern nowadays. Businesses are adopting the cutting edge technologies and best practices to champion the rapid changes in the world. Various business functions are being reengineered for this purpose. Typical accounting functions play an important role in businesses to maintain competitive advantages. However, some Small and Medium Enterprises (SMEs) face problem in handling their accounting functions. This is due to the lack of expertise as accounting functions do not only require knowledge of generally-accepted accounting rules or the tax regulation, but also require that one knows how to apply the rules in a given business environment (Everaert et al., 2006). This paper presents a case study on Malaysian SME's accounting function outsourcing practices. A survey was conducted among SMEs to identify the overall scenario on outsourcing the accounting functions to third party organisation. A total of 1500 companies were selected through systematic sampling method for a total of 15,058 SMEs in Malaysia. However, only 164 companies responded the online questionnaires. The data were analysed to look at the level of participation of SMEs in terms of accounting outsourcing practices. The findings revealed various facets of outsourcing practices among SMEs touching the accounting functions.

Key words: outsourcing, accounting, SME,

1. INTRODUCTION

Generally, accounting functions are the fundamental source of accounting information. Accounting functions such as general ledger, account receivable, account payable and payroll are essential in business. These functions can be easily handled by purchasing accounting software which is user friendly and available in market such as User Business System (UBS) and Mind Your Own Business (MYOB). However, the diversity of businesses in the world have created disadvantages to the SMEs capabilities in order to sustain their competitive advantage since resource constraints generally are much more significant for SMEs than they are for large firms (Marriott and Marriott, 2000). Svedberg et al. (2006) found that many large companies dedicate employees or even whole departments to handle a certain function of a company. Most certainly, SMEs do not have these resources. Fortunately, the presence of outsourcing practices has offered a great helping hand or an alternative for business survival in general for SME.

United Nations Conference on Trade and Development [UNCTD] (2000) found that generally, SMEs plays important role to economic growth development in both developed and developing countries. However, 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 (UNCTD, 2000). Ismail (2002) added that SMEs are lacking accounting knowledge and support to perform accounting functions 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. (UNCTD, 2000).

It is no longer an easy task to sustain a competitive advantage in the global business environment nowadays. Previously, accounting functions served mainly for month end reporting or record keeping purposes. Today, the evolution of

accounting such as management accounting has made accounting functions to have more roles to play in any business. Moreover, it has created an advantage for business competitiveness in the market. Businesses able to sustain their competitive edge as managements are looking at the accounting information for appropriate decision making. In short, accounting functions seem to be relatively important in every business operation.

However, in the context of diverse businesses, SMEs seem to have disadvantages in sustaining a competitive advantage in terms of capital and resources. In accounting, a resource deficit means that the company is lacking in terms of people or knowledge to fulfil the accounting functions. The higher the resource deficit, the more attractive outsourcing option becomes (Dibbern & Heinzl, 2001). This is particularly relevant for SMEs, since resource constraints generally are much more significant for SMEs than they are for large firms (Marriott and Marriott, 2000). Ismail (2002) claimed that most of the small and medium enterprises (SMEs) tend to outsource their accounting works to accounting firms due to lack of accounting knowledge and support. This is because they rely on the statutory accounts as their main source of information.

UNCTD (2000) stated that many SMEs lack skilled accounting personnel and infrastructure to implement existing accounting rules and regulations. As further elaborated by Everaert et al. (2006), SMEs lack of access to expertise because the accounting functions do not only require knowledge of generally-accepted accounting rules or the tax regulation, but also require that one knows how to apply the rules in a given business environment. Apart from that, Ismail (2002) added that SMEs do encounter difficulty to draw and retain skilled employee. This may due to less number of expertises and insufficient of knowledgeable accounting support to handle full set of accounts. As an alternative, some SMEs choose to outsource accounting works relative to utilize a highly paid accountant. Although Bragg (2006) and Burkholder et al. (2006) have discovered the reasons and risk factors of outsourcing business function in general, however, those

studies were performed abroad. Therefore, this study will explore the reality of Malaysian SMEs in terms of outsourcing accounting functions.

Research Questions

1. Do SMEs outsource their accounting functions?
2. What type of SMEs choose to outsource their accounting functions?
3. What are the accounting functions being outsourced?
4. How long do they outsource?
5. What is their satisfaction level in outsourcing the functions?

The research objectives of study relates to the overall examination of the SMEs outsourcing accounting functions.

Research Objectives

1. To determine involvement of SMEs in outsourcing accounting functions.
2. To determine the range outsourcing practices in terms of firm size and types of industry.
3. To examine the accounting functions which are most outsourced.
4. To examine the length of outsourcing period and its relationship to satisfaction level.
5. To determine the general orientation in outsourcing accounting functions among SMEs.

2. LITERATURE REVIEW

2.1 SME Defined

Businesses in Malaysia not only can be categorized in terms of types but in sizes as well. In 2005, the National SME Development Council (NSDC) approved the use of common definitions for SMEs in categories of sectors;

- Manufacturing (including agro-based),
- Manufacturing-Related Services (MRS),
- Primary Agriculture,

- Services (including Information and Communication Technology).

These definitions are set by all Government Ministries and Agencies involved in SME development, as well as by the financial institutions (Bank Negara Malaysia, 2007).

Malaysian SMEs can be grouped into three categories; Micro, Small, or Medium. These groupings are decided based on two assessable criteria; either

- the numbers of people a business employs (Table 2.1), OR
- the total sales or revenue generated by a business in a year (Table 2.2).

Table 2.1: Definition of SME based on the number of full time employees

Sector Size	Primary Agriculture	Manufacturing (including Agro-Based) & MRS	Services Sector (including ICT)
Micro	Less than 5 employees	Less than 5 employees	Less than 5 employees
Small	Between 5 & 19 employees	Between 5 & 50 employees	Between 5 & 19 employees
Medium	Between 20 & 50 employees	Between 51 & 150 employees	Between 20 & 50 employees

Source: Bank Negara Malaysia (2007)

Table 2.2: Definition of SME based on annual sales turnover

Sector Size	Primary Agriculture	Manufacturing (including Agro-Based) & MRS	Services Sector (including ICT)
Micro	Less than RM200,000	Less than RM250,000	Less than RM200,000
Small	Between RM200,000 & less than RM1million	Between RM250,000 & less than RM10 million	Between RM200,000 & less than RM1million
Medium	Between RM1million & RM5 million	Between RM10 million & RM25 million	Between RM1million & RM5million

Source: Bank Negara Malaysia (2007)

SMEs have become the essence of Malaysian commerce. According to Hashim (1999), SMEs' business activities have turned out to be an important component in the Malaysian economy as their contribution of economy can be seen from the goods and services provided, employment enhancement and income generated. Currently, SME's business activities are rapidly expanding throughout Malaysia. In the fast changing world of business, SMEs are progressively acting as a force for national economic resilience and contributing towards growth (UNDP, 2007).

2.2 Accounting Functions

Accounting is the measurement, statement or provision of assurance about financial information primarily used by managers, investors and other stakeholders or decision makers to make resource allocation decisions within companies, organizations, as well as public agencies. Accounting is also the process of measuring, communicating and interpreting financial activity. Accounting is also widely referred to as the "language of business (Meigs, 1970, p.1). In addition, Drury (2005, p.6) described that accounting is a language that communicates economic information to people who have an interest in an

organisation such as managers, shareholders and potential investors, employees, creditors and the government.

There are many types of accounting functions in business. Alan (2002, p.50) found that finance and accounting functions are ranging from account payable, account receivable, general ledger, internal audit services, lease administration, payroll, property accounting, sales audit to tax. Based on IDC report, the accounts payable remains the most outsourced accounting function (Casale, 2004)

Bamford and Bruton (2006, p.180) defines the accounting functions as follows:

- i. *Account receivable* - the record of receivables are vital not only decision making on credit extension but also for billing accurately and maintaining good customer relations. An analysis of these records will reveal the effectiveness of a firm's credit and collection policies
- ii. *Account payable* - the record of liabilities show what the firm owes the suppliers, facilities the take cash discount, and allow payment to be make when due.
- iii. *Inventory account* - is essential for the control and security of inventory items. Inventory record supply information for use in making purchases, maintaining adequate stock levels, and computing turnover ratio.
- iv. *Payroll* - show the total salaries paid to employee and provide a base for computing and paying payroll taxes.
- v. *Cash record* - showing all receipt and disbursements are necessary to safeguard cash. It provides essential information about cash flows and cash balances.
- vi. *Fixed asset account* - show the original cost of each asset and the depreciation taken to date, along with other information such as the condition of the asset.

Other accounting functions which are vital to the efficient operation of a small business are the insurance register, record of leaseholds, and record of the firm's investments outside its business (Krell, 2006).

2.3 Outsourcing Accounting Functions

The outsourcing of accounting and finance functions will become prevalent and continue to grow (Shailendra, 2004). The global market for outsourcing finance and accounting functions is expected to grow at a 9.6% compounded annual growth rate (CAGR), and top \$47.6 billion in 2008, according to a new report from IDC (Casale, 2004). Longenecker et al. (2003, p. 408 & 349) defines outsourcing as buying products or services from outside business firms and usually the outsourcing is making for those non-core activities of the firm. Krell (2006) stated that outsourcing refers to the transfer of responsibility, indicating that a process of function is performed by a third party. In addition, Brown and Wilson (2005, p. 20) states that outsourcing take steps of getting services from external source.

Krell (2006) has mentioned that some components of accounting functions are suitable to be outsourced such as general ledger, financial reporting and internal services. The abstraction of elements of business outsourcing for operations finance and accounting services are as follows:

- General accounting
- Audit
- Accounts payable
- Banking
- Financial services solutions
- Credit services
- Insurance processing
- Tax Services
- Billing systems
- Accounts receivable
- Collections and credit
- Compliance
- Management Reporting

The accounting function is among most commonly outsourced, though this is usually limited to only a few of tasks within the function, however, there are opportunities to outsource a wide array of services in this area if a company is willing to work with multiple suppliers to achieve this goal (Bragg, S.M. , 2006, p 129). For instance, cash management services are offered by most regional banks. Taxation, financial reporting, and internal audit services are provided by all of the largest auditing firms, such as Ernst & Young LLP and Deloitte & Touche LLP.

Outsourcing Accounting Online to India [OAOI] (2007) suggested that by switching to outsourcing of accounting, it enables companies to reduce overhead and focus on their core business. In addition, they also mentioned that the time spent on bookkeeping problems would add little or rather no value to a company's customer relationship. Moreover, they also said that outsourcing services helps such companies manage their work well. As the total cost for managing the accounting work by outsourcing firm is far lesser than hiring in-house staff, almost every company is making accounting outsourcing a part of its long-term sustainable business model (OAOI, 2007).

Outsourcing of accounts payable helps in reducing the administrative costs and cost saving without capital investment. The accounts payable outsourcing services includes data capture, data processing, invoice entry and payment disbursement. The technology is capable in transforming the accounts payable; by outsourcing the accounts payable, it improves the accountability, reduces cost and effort in the SMEs (OAOI, 2007). When come to paying taxes and filing returns usually it means taking valuable time out of SMEs core business operation. By outsourcing tax processing, SMEs can save time and avoid penalties arising from late payment and filing. SMEs can stay free from the pressure or keeping track of changing laws and the latest technology (OAOI, 2007).

However, outsourcing should be undertaken with caution as there will be loss of direct control over quality and leads to additional coordination expense and delays where prompt management and business decision will be affected; besides, it will also jeopardizes employee loyalty because of the job-loss fear (Brown & Wilson (2005),

Aubert et al (1998), Earl (1996)). Another concern of having outsourcing is the exposure to data security and customer privacy issues. This will also atrophies of in-house capability to perform outsource services. Finally, the dependence on one supplier compromises future negotiation leverage (Bragg, 2006).

3. METHODS AND MEASURES

An online questionnaire-based survey was conducted. The unit of analysis is SME companies. The information of SMEs such as address, e-mail and contact numbers can be obtained from Online SME Info Portal (www.smeinfo.com.my). 1500 companies with email addresses were selected using systematic sampling method from SME Info Portal website of the total of 15058 numbers of companies registered as at 18th October 2007. This represents approximately 10% of the total SMEs in the country. However, there were 395 numbers of SMEs registered with either non-existing e-mail or false e-mail.

4. RESULTS AND DISCUSSIONS

4.1 Profile of SMEs Selected for Analysis

As shown in table 5.1 below, in terms of types of business, majority of respondents were from partnership type of business which accounted for 39 per cent, 33.5 per cent are sole proprietors and 27.5 per cent are private limited companies. This shows the random selection is important to generalisability of the findings. The firm size which includes micro, small, medium and others, small size companies fetch the highest count (108). Slightly more than half (52 per cent) of the companies have number of employees between 5 to 19. Meanwhile, a total of 68.3 percent of the respondents were from firms that are of 10 years old and below. Where type of business is concerned, 49 percent of companies are from manufacturing related businesses.

Table 4.1: Demographic Profile

Profile	Frequency	Percentage (%)
Types of Business		
Sole Proprietor	55	33.5
Partnership	64	39.0
Private Limited	45	27.5
Total	164	100.0
Firm Size		
Micro	36	21.9
Small	108	65.9
Medium	18	11.0
Others	2	1.21
Total	164	100.0
No. of Years in Business		
Less than 5 years	55	33.5
Between 5 to 10 years	57	34.8
Between 11 to 15 years	17	10.4
Between 16 to 20 years	18	11.0
More than 20 years	17	10.4
Total	164	100.0
Type of Business		
Manufacturing (include Agro. based)	41	25
Manufacturing Related Service	39	24
Services (include ICT)	54	33
Primary Agriculture	27	16
Others	3	2
Total	164	100
Number of Employees in the Firm		
Less than 5	36	22
Between 5 and 19	86	52
Between 20 and 50	36	22
Between 51 and 150	6	4
Total	164	100

4.2 Analysis on Outsourcing Accounting Functions and the Sampled SMEs Involvement in Outsourcing

In terms of their involvement in outsourcing accounting functions, more than two third of SMEs sampled have some form of outsourcing accounting practices (see Table 4.2). This is now considered standard practice among businesses in many parts of the world. Given the general anxiety over the adoption of outsourcing practices by companies, this gives a positive assurance to the users. The remaining 27.4 percent companies are probably still harbour doubts about the practicality of outsourcing practices when dealing with third party or vendors. It perhaps also reflects an attitude of the conventional service where the benefit of outsourcing is implicit in the dealing and no explicit assurances are made nor felt necessary. The immunity of the vendors from any negligent use of intellectual property or trade secret could also in part contribute to this inattention.

Table 4.2: Involved in Outsourcing of Accounting Functions

	Frequency	Percent
No	45	27.4
Yes or previously yes	119	72.6
Total	164	100.0

The survey revealed that the small firms tend to outsource their accounting functions the most. It was discussed earlier that small firms do have resources and competencies deficit, thus they tend to outsource their accounting functions to third party (Figure 4.1). In terms of industries, a remarkably high frequency in outsourcing is recorded for organisations in the category of services (include ICT) industry (Figure 4.2).

Figure 4.1: Firm Sizes & Outsourcing of Accounting Functions

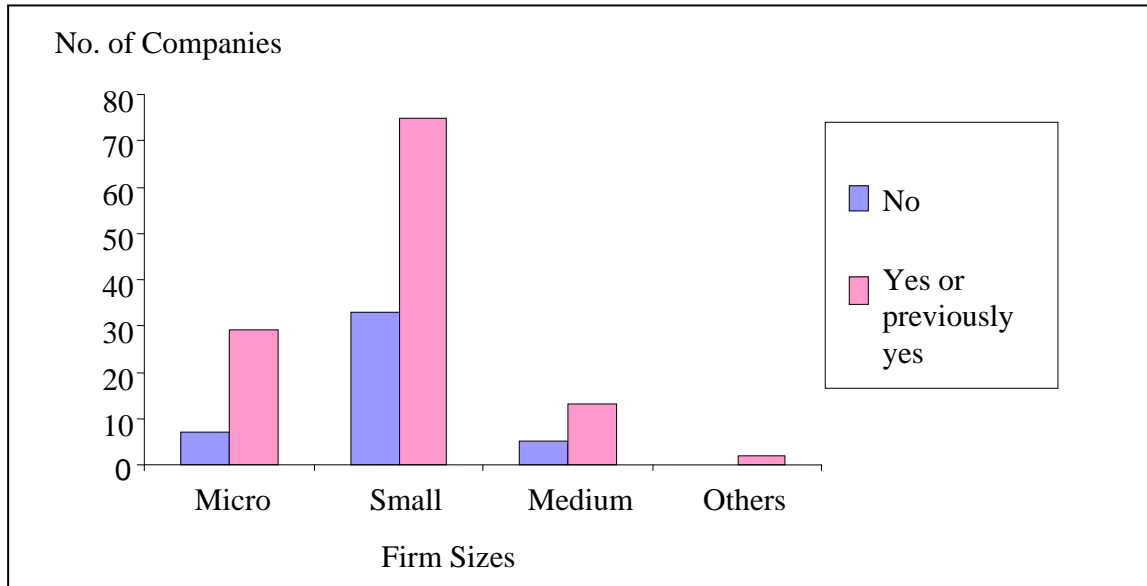
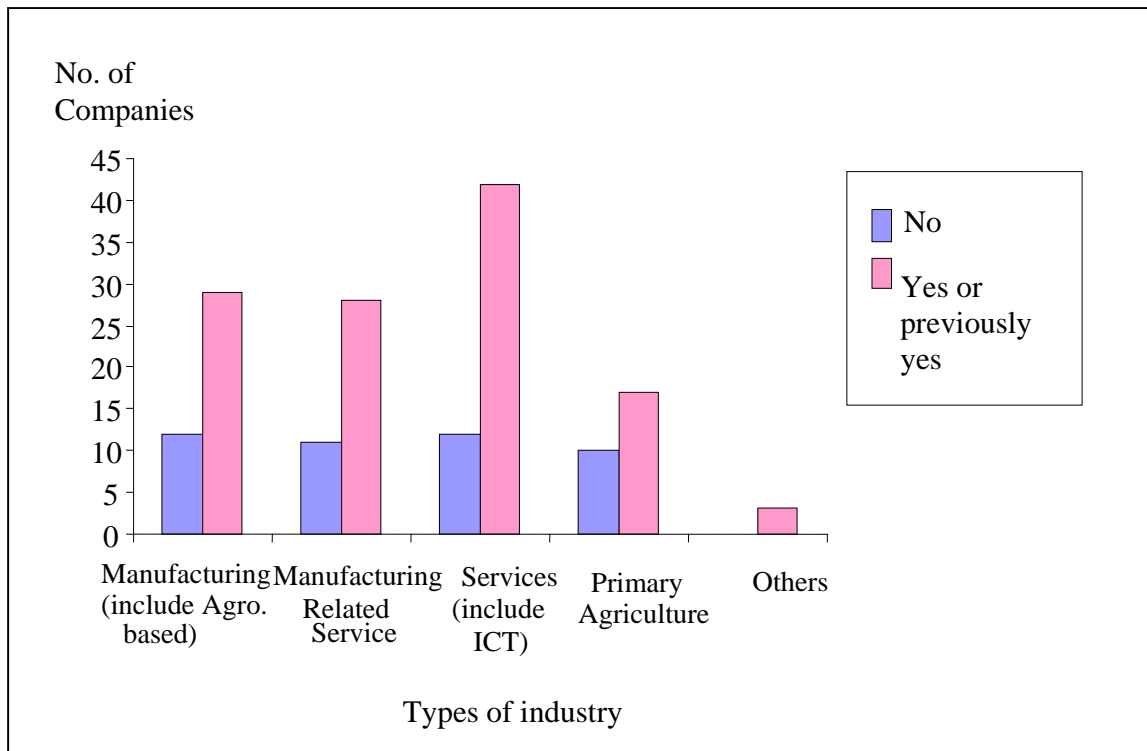


Figure 4.2: Types of Industry and Outsourcing of Accounting Functions



Accounting Functions Outsourced

We further sliced the analysis into the types of accounting functions outsourced based on the standard functions which include bookkeeping, Accounts Receivable, Accounts Payable, financial reporting, management reporting and tax filing. The sampled SMEs revealed that in the descending order, financial reporting (236), account payable (228), management reporting (227), and bookkeeping (211) are the most four outsourced functions (Table 4.3).

Table 4.3
Components of Outsourcing Accounting Functions

	Book keeping	Accounts Receivable	Accounts Payable	Financial Reporting	Management Reporting	Tax Filing
N Valid	119	119	119	119	119	119
Missing	45	45	45	45	45	45
Mean	1.77	1.29	1.92	1.95	1.91	1.51
Sum	211	153	228	236	227	180

Length of Outsourcing Period

A number of pundits have referred outsourcing relationships as marriages (Lacity, et al, 2008). Slightly more than half of the respondents, about 59% (96) companies revealed to have outsourced their accounting functions for more than 12 months and longer period. Longer period of outsourcing may be the result of renewal of primary contracts. The renewal of contracts not necessarily reveals that partners are still thrilled with each other instead it is because of high switching costs (Lacity, et al, 2008), the SMEs remain to outsource their accounting functions. On the other hand, there are 14% (23) companies outsourced the accounting functions for less than 12 months (Table 4.4).

Table 4.4: Length of time in Outsourcing of Accounting Functions and Level of Satisfaction

	Frequency	Percent %
Less than 12 months	23	14.0
More than 12 months	96	58.5
Total	119	72.6
Missing 99	45	27.4
Total	164	100.0

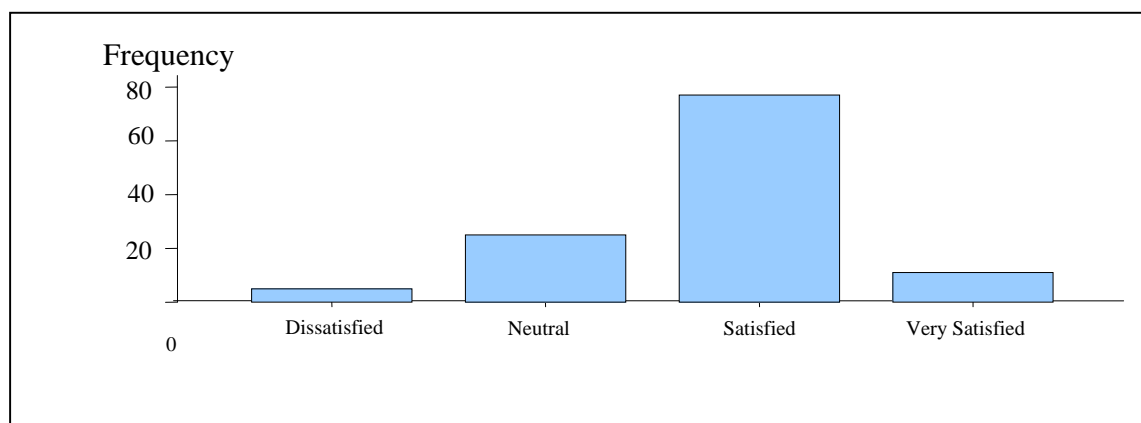
Level of Satisfaction

On a related question of whether they were satisfied with the services provided for outsourced function, they show that 68.9 per cent of the 164 respondents rated their overall satisfaction as neutral or above. The most frequent score was satisfied, from 77 respondents. However, a small portion (3 per cent) of the SMEs is dissatisfied with their outsourcing arrangements (Table 4.5 and Figure 4.3).

Table 4.5: Level of Satisfaction

Level of Satisfaction	Frequency	Percent %
Dissatisfied	5	3.0
Neutral	25	15.2
Satisfied	77	47.0
Very Satisfied	11	6.7
Total	118	72.0
Missing 99	46	28.0
Total	164	100.0

Figure 4.3: Level of Satisfaction



5. CONCLUSIONS

The primary value and benefit of outsourcing accounting functions has been in opening up new and novel ways of extending the services to business today. Vendors are extending the services to SME's door step. The focus on core competencies is a key attraction of outsourcing practice. From the researchers' vantage point, about 70 per cent of the SMEs sampled appeared to establish some sort of outsourcing accounting functions. However, the level of satisfaction among SMEs from the experience of outsourcing accounting functions is still not very inspiring.

We conclude that outsourcing of accounting functions is an option for SMEs in order to maintain a competitive advantage in the business world environment as outsourcing could lessen the burden borne by SMEs. Accounting functions play an important role in today's business. As a result, SMEs need to be aware and convinced of the usefulness of accounting information for better management control and decision-making purposes in order to access new markets and maximize their profits in the corporate world.

Future study should implement a research design to the extend of having interview with more SMEs, in order to investigate further what triggers SMEs to outsource their accounting functions and not just based on the e-mail questionnaire survey as it is not sufficient, not valid and the respondent is unknown. In additional, the findings of this study are applicable in general context of SMEs. Therefore, it is recommended future study to go more in depth, to study on a given different firm sizes what are the contributing factors lead to outsourcing of accounting functions, and also in a given different types of industry of Malaysian SMEs. This study will provide useful information for more narrowly defined users according to the circumstances studied.

Last but not least, there would be an interesting avenue for the future study which is to identify whether the outsourcing of accounting functions are familiar to the listed companies or large firms as well as what are the contributing factors that lead them do so since the study on SMEs has already been carried out.

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