



## **Issues relating to cash flow management for SMEs after the introduction of the GST**

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### **Abstract**

This paper explores the issues relating to cash flow management practices on small businesses in a regional area of Australia (the Mid North Coast of New South Wales) after the introduction of the goods and services tax (GST) in 2000. There have been other studies carried out on the impact of the GST but with only limited research on small business in regional areas (Petzke and Murphy, 2001). The outcome of the paper is to foster some discussion on SME policy direction in this area.

Research has evolved over time from the literature on small business failure and poor cash flow management. Some examples are that Berryman (1983) found that small business failure inevitably showed poor or careless financial management whereas Peacock (1985) found that record keeping was a major problem for small business. In the United States, Dodge et al (1994) identified from a small business survey issues related to internal problems of inadequate capital, cash flow management and inventory control. Peel and Wilson (1996) found that there was a dearth of both theoretical and empirical small business research relating to cash management. The latest research in Australia was conducted to identify reasons why small businesses do not use computerised record keeping processes (Breen and Sciulli, 2002) which highlights some of the effects of cash management practices of small businesses in regional Australia.

The data for this paper was collected from a questionnaire relating to the GST, in 2001, twelve months after the introduction of the new tax. Small businesses were asked whether any changes had taken place in their business since the GST tax. The sample businesses were from both manufacturing and service industries. The database used to collect the names and addresses of the businesses was the Business Enterprise Register, which is located at Southern Cross University (Coffs Harbour – campus). Comments from the questionnaire have been tabled under relevant headings and analysed.



The findings from this paper indicate that there is still limited research in the area of cash flow management practices in Australia. Further studies need to be conducted to address some of the issues that may impact on policies for the small business community.



## **Issues relating to cash flow management for SMEs after the introduction of the GST**

### **Introduction**

This study examines a sample of small businesses on the Mid North Coast of New South Wales, Australia twelve months after the introduction of the GST. The objective of the research was to explore the issues relating to the GST and note significant changes in the businesses in relation to cash flow management practices. Breen and Sciulli (2002) identified reasons why small businesses do not use computerised record keeping processes and outlined some of the differences between manufacturing and non-manufacturing sectors. This leads to exploring cash flow management practices and in particular recording keeping issues.

Theoretical and empirical literature on cash management has been debated not only in Australia but overseas (Peacock, 1985; Peel and Wilson, 1996; Chittenden et al, 1998) but as far as academic literature on the GST in Australia and its impact on small business is concerned, there has been little debate (Petzke and Murphy, 2001). Research has been conducted in the areas of the Value Added Tax (VAT) for the United Kingdom (UK) and the Goods and Services Tax in both New Zealand and Canada on the cost of compliance and various forms of taxation (Petzke and Murphy, 2001). There is a lack of studies in Australia about the GST.

Small business failure can inevitably be related to poor or careless financial management (Berryman, 1983; Peacock, 1985). Research in the United States reported the internal problems related to cash flow management, inventory control and inadequate capital (Dodge et al, 1994) whilst in the United Kingdom, Peel and Wilson (1996) and Chittenden et al (1998) found that there was a dearth of both theoretical and empirical small business research relating to cash management.



Cash management research in Australia has been limited (Peacock, 1985; Petzke and Murphy, 2001; Breen and Sciulli, 2002). This study deals with the issues pertaining to small business in relation to cash management practices that would be beneficial for their sustainability and growth.

## **Methodology**

This study involved a review of the literature into similar taxes implemented overseas and cash flow management practices. The findings from the literature highlighted the need to ask a specific question about the GST in the area of cash flow management.

The database located at Southern Cross University, Coffs Harbour known as the Business Enterprise Register was used for this study. It has more than 13,000 small businesses listed from Port Macquarie (two hundred and ten kilometres drive south of Coffs Harbour) to Maclean (one hundred and fifty kilometres drive north of Coffs Harbour), an area known as the Mid North Coast of New South Wales, Australia. A proportion of manufacturing and non-manufacturing businesses were randomly selected from the database following Chittenden et al's (1998) study where 40 per cent of the businesses were manufacturers and the other 60 per cent from the service industry.

A sample of 1,658 small businesses that employed less than 20 staff were sent a questionnaire covering cash management issues, with a particular question relating solely to the GST. The question related to whether cash management practices changed after the introduction of the GST. Of the 539 questionnaires returned, 159 were completed with another 380 questionnaires returned from small businesses that had either moved or closed operations. This study is mainly qualitative and focuses on issues relating to the GST based on the comments made by owner-manager's of small business in regards to the cash management changes after the implementation of the GST in Australia.



Figure 1 shows the percentage of responses to the question relating to ‘*Has the GST changed your business in any regards to management of cash*’.. The overview of the small businesses surveyed showed a mixed response as to whether there were changes or not after the introduction of the GST. Only 34 per cent stated there were changes in their business, with another 39 per cent recording no change at all. The surprise was that 27 per cent were undecided and they were the ones that made in depth comments as to the impacts of the GST.

*Figure 1: Responses to any changes to the management of cash flow*

<b>Yes</b>	<b>No</b>	<b>Undecided</b>
34%	39%	27%

### **Summary of the GST Impacts on Small Business**

The responses set out in Table 1 shows a summary of the impacts on small businesses in regards to any changes to management of cash after the introduction to the GST. The majority of small businesses have issues relating to timing and control (27 per cent) and cash flow (20 per cent). At the other end of the scale under the heading ‘other’ were issues related to cash and invoicing. Those ‘other’ comments related to charging of the GST in the following manner “*Cash only accepted or full GST is charged*” with another comment “*Because they are now aware the government is ripping them off an extra 12 per cent and no tax cuts to go with it. Their pay packet and mine are now 12 per cent less. I do not charge GST as our total income is lower than the threshold amount*”.. Socka (1991) raised some concerns about the GST implementation in Canada on determining whether the item, customer or transaction are taxable or not and at what rate of tax. If the tax charged was not enough the company would make up the shortfall but when overcharged created collection problems and the customer would lodge a complaint.



*Table 1: Impacts relating to cash management after the introduction of GST*

<b>No</b>	<b>Group</b>	<b>Per cent</b>
1	Control of debtors and creditors	27
2	Cash flow and cash allocation	20
3	Record keeping	12
4	Separate bank account for GST	9
5	Downturn in business	8
6	Other	5
7	Too many taxes	4
8	Increased work load due to GST	4
9	Bank overdraft	3

The literature supports the comments under each of the above groups and verifies that the GST did raise concerns for small businesses in the area of cash flow management as outlined in Table 1.

### **1. Control of debtors and creditors**

Chittenden et al (1998) reported that granting of credit has existed as long as trade itself. They also state that trade credit is an important source of short-term finance because it represents a substantial component of the business assets and liabilities for the small business. In their findings they found that more than 96 per cent of small businesses provide credit to their customers.

In addition, the impact of trade debtors and trade creditors after the introduction of the GST has had a compounding effect on cash management practices. McMahon and Holmes (1991) found that owner-managers tend to neglect accounts receivable management and that it is exogenously determined and beyond their active control. On the other hand, Chittenden et al, (1998) reported that management of accounts receivable is paramount to the survival and success of every business. A



number of small businesses expressed concern about the control of creditors and debtors in the following examples, *“Payments of our invoices are a lot slower”* to another reinforcing statement *“Debtors are slower to pay their accounts”*. A UK study found that trade debtors represent 28 per cent of total assets, whilst trade creditors are equivalent to 11 per cent of total assets (Chittenden et al, 1998).

In contrast, trade debtors levels in a business can absorb cash and therefore result in low or negative levels of cash flow, the effect of which can result in the bills being paid late or impossible to pay at all (Scott, 1991). So the collection of past-due receivables can make a significant contribution to a company’s cash flow (Perry, 1995). The following exemplifies a business having difficulty controlling both the debtors and creditors, *“Slower payments in, and more bad debtors”* and *“Made collection a little more difficult”*. Hartcher (2001) found that there was a 7 per cent improvement of debtor payments and a negative impact response of 40 per cent. She also found that 21 per cent were slower paying creditors.

Chittenden et al (1998) found that late payment in all sectors in the United Kingdom related to trade debt and the same problem continues in Australia where the small business experience that paying on time has become an issue and can be evaluated by the following comments *“Most businesses are reluctant to pay on time which has a flow on of us not being able to meet our creditor payments on time”*. This raises awareness that some businesses are actually experiencing later payments *“Debtors payment pattern has worsened – out an extra five days”* to they have *“Tighter control of credit terms and debtors generally. GST collected is banked into line of credit account on weekly basis and drawn quarterly to pay GST – reduces interest”*



## 2. Cash flow and cash allocation

The UK study found that even if a company does not have the necessary internal cash flow to take advantage of trade discounts, substantial cost saving would result in borrowing the money to settle accounts (Chittenden et al, 1998). In addition the survey found that businesses face a significant opportunity cost by building up cash reserves to buffer any downturn (Chittenden et al, 1998). In fact 54 per cent from the UK study have had surplus cash in the business on a regular basis, especially in the service businesses (Chittenden et al, 1998).

A negative aspect of the Australian study is that cash flow is related to small business owner-managers when the claim is, *“Business in this area fluctuates dramatically and if cash flow decreases the quarterly GST, PAYG and superannuation and personal tax are quite difficult to meet – sometimes its not feasible to put enough in a separate account and still pay creditors on time”*. The following is a positive comment about cash flow *“GST has made us more aware of cash flow. By submitting a GST every 3 months we now know how our business is going. Tax and GST is paid together with account, and there is no large sum at end of year. This allows us to budget for our personal expenditure”*. Hartcher (2001) found that 13 per cent of small businesses allege the GST had a positive impact on their cash flow and 56 per cent assert the GST had a negative impact, but 33 per cent said that GST had a positive impact on their ability to monitor cash flow and 24 per cent said it had a negative impact. Whereas 67 per cent of accountants said the GST had a positive impact on their clients’ ability to monitor cash flow.

## 3. Record keeping

The literature states that there is clearly significant progress in encouraging small businesses owner-managers to install and use accounting information systems (McMahon and Holmes, 1991). Record



keeping of small business has improved with the GST and this is reported by the following comments “*GST is a great tax! It teaches you to manage the cash or you’ll have no cash*” to another small business owner-manager stating that “*More diligent with account keeping*”. McMahon and Holmes (1991) raised the issue financial management practices for the small owner-managers’ is limited and they require education and training to the point where operating a small business utilises cash-based accounting systems to provide an acceptable level of financial control.

Breen and Sciulli (2002) report that, in order to reduce the cost burden on small business, a number of mechanisms were put in place. It started with the write-off by the Australian Tax Office (ATO) of GST related software for businesses with a turnover of less than \$10 million, followed by the ATO free software package called E-record to record all transactions. All of this was to encourage small business to utilise computerised technology.

In addition, Breen and Sciulli (2002) found many New Zealand small businesses moved to computerised accounting packages because GST was too complicated with manual records. It has been evident that Australia small business record keeping has improved because of the reporting of quarterly or monthly Business Activity Statement (BAS) returns. With that being the case, one small business operator stated “*It has made us tighten up in every area of our operation especially administration. I feel if you can conduct a viable business in regional Australia, you could do it “on your ear” anywhere else*” and another comment dealing with record keeping was “*Far more time is spent updating records, reconciling all records. Instead of doing annual tax returns we had to employ an extra person, part-time to cope with extra work-load. The additional time spent has caused stress on business and family*”. Therefore the positive response to record keeping has been “*More accurate record keeping*”



Breen and Sciulli (2002) report the main reasons for not using computerised record keeping system were:

- Satisfied with their present system 31.4%
- Lack of computer skills and knowledge 25.6%
- Cost 9.3%
- Lack of time 8.1%

The above indicates many owner-managers are continuing with manual bookkeeping and lack computer skills and knowledge, which is consistent with the comments made about record keeping.

#### **4. Separate bank account for the GST**

It is interesting to note that more than one small business opened an extra bank account to manage the GST administration. Some of the comments were from a positive aspect: *“Have to have a separate account for GST”* to the response *“I keep a separate account to deal with GST and tax”* and another *“Separate bank account maintained to cover quarterly BAS amount. Funds transferred each week to this account from working account”*. This may indicate that small business needs to address the issue of opening a separate bank account to assist them better manage cash flow.

The next comment is from a business that is not in favour of separate accounts *“Business in this area fluctuates dramatically and if cash flow decreases the quarterly GST, pay tax, superannuation and personal tax payments are quite difficult to meet - sometimes its not feasible to put enough in a separate account and still pay creditors on time. Our business is kitchen manufacturing”* to *“More diligent with account keeping”*. The following comment completes this section *“Opening a GST account”*.



## 5. Downturn in business

Berryman (1982) found management inefficiency was the predominant cause of small business failure. Breen and Sciulli (2002) reported that particular industries are more suited to computerised record keeping than others. They found that accounting for the GST was extremely time-consuming in the building, construction, retail, wholesale and service industries and these were least likely to be computerised. They report the GST created additional paperwork at various times during the year and was a major trigger to increasing workloads in the business (Breen and Sciulli, 2002), which provides evidence that small business do not help to improve their management skills.

In addition Booth and Hutchinson (1989) report a downturn in the business can lead to both failure and growth. When an owner-manager states there is a downturn in the business, it should be investigated further. A range of businesses reported a downturn in business, “*Since the GST business income has dropped 29%*” to another comment “*Business has dropped in the last 12 months because of the GST*”. What has happened in the last twenty years to help these small business owner-managers?

Chittenden and Bragg (1997) report that when a small business is suffering from late payment there is an increase in short-term bank borrowing, or delay in payments to creditors. When this occurs small business then has to over commit themselves which leads to the next two comments that “*There is a definite down turn since GST. Money is very much tighter. In an arts and craft business experiencing very much reduced turnover*” and “*I spend a lot more time monitoring cash flow, with more work and less cash*” sums up what the small business owner-manager is experiencing. Petzke and Murphy (2001) reported that the introduction of the GST and consequent reporting requirements had put stress on marriages and ‘ruined some small businesses with red tape’.



## 6. Other

Many owner-managers are actively involved in trying to get customers to pay cash without paying any of the GST, one such example is: *“Although I am not included in the GST myself, my clients complain about how they have less money to spend on luxuries – such as those extra services they may previously have considered”*

The credit policy for many small businesses has changed since the introduction of the GST. Some of the comments relating to credit policy reflect this: *“Introduced tighter credit controls. Chase customers when outside of the Terms of Payment”*

## 7. Too many taxes

The burden of the extra workloads for owner-manager completing BAS statements and making sure that the right amount of GST was charged has resulted in the owner-manager using the accountant for the extra paperwork. Accountants should ensure owner-managers are informed about the costs and benefits of various record keeping procedures and to provide information to their clients to assist in informed decision making (Breen and Sciulli, 2002).

The following comments reflect the positive aspects of tax *“GST is a great tax! It teaches you to manage the cash or you'll have no cash, and turn into the whingers that don't have a sustainable business”* and *“GST is better than Sales Tax and we have approximately two months to collect money where sales tax, we had to pay fifteen days after end of month (current)”*.

The negative comments related cash flow and tax *“I don't have the cash flow, can't seem to build up my account. It builds up then it's emptied out paying GST, staff tax and superannuation. It's*



*becoming very undesirable to be in small business, especially employing staff – my highest expense!”*

In essence the small business owner-manager should be encouraged to computerise their record keeping to overcome the additional work in preparing tax returns and this would then free them to develop strategies to grow the business (Breen and Sciulli, 2002). Hartcher (2003) found 41 per cent of small businesses were paying more in accounting fees, which would impact on cash management. She found that 73 per cent said that the compliance obligations act as an incentive to keep up to date with record keeping.

#### **8. Increased workload with the GST**

Petzke and Murphy (2001) state for 516 small business owners the GST cost them 171.15 hours for the year, 14.26 hours per month. A significant number of small businesses reported to their local accountants *“There isn’t any cash left!”* and were really struggling to keep their businesses afloat, making statements such as: *“Just made life a little more difficult for everyone”* and *“more work”*. Petzke and Murphy (2001) found it cost small business an average of \$4,545 in additional costs for staff and professional advisors in the first year with the implementation of the GST and the accompanying BAS.

The following comment relates to the amount of time spent *“An extra 12 hrs a week is spent maintaining accounts, cash book, and recording GST”* to another comment *“Less cash at end of month and has increased our time taken to pay accounts”*. Breen and Sciulli (2002) state that governments should give incentives when small business computerising their accounting information systems a priority.



## 9. Bank overdraft

Poutzouris et al (1998) claims that a bank overdraft has been an issue for small business for some time but with the extra taxes banks have taken an initiative to get small business to set up separate accounts to keep the taxes from the normal operating of the business. Some of the responses from small business were “*We have changed our fixed bank loans into a larger overdraft account to account for the increased quarterly fluctuations*”.

## Conclusion

It is apparent from the discussion that there is need for improve cash flow management practices of Australian small businesses. The above results show that there are positive and negative comments towards the GST. The GST has had impacts on cash flow management practices not only with better record keeping, but also better control of trade debtors. It would be encouraging if a government policy could be implemented to encourage the development of strategies for cash flow management practices for all small businesses.

In addition the results provide evidence to support the view that the GST issues has improved the record keeping of small business. The downside has been that many owner-managers have lost business due to the GST. It will be interesting to see what comments about the GST will be made in another twelve months time as to whether small businesses have embraced the tax fully.

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