

Application of Management Accounting in Informal Sector Businesses in Janakpurdham Sub - Metropolitan City

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Abstract: *There is a greater contribution of informal sector entrepreneurs to the nation in Nepal. Since it is difficult to update the statistics of such businesses, Nepal may take advantage of developing micro-business into small and medium industries after micro-level study. Informal level businessmen can be trained and motivated to develop as an industrialist. Taking this idea into account, this study was carried out to find how informal entrepreneurs develop a strategy on the basis of a management accounting point of view. Four informal businesses in the Tarai region were selected for the study. A depth interview was carried out with the owner of the business. The study concluded that informal sector entrepreneurs are strategic even though they don't maintain the books of account, produce financial reports like systematized businesses. Their strategies were seemed for the present time but not for the long run because they lack the know-how.*

Keywords: Cash inflow and outflow, informal sector entrepreneur, management accounting, strategy

1. Introduction

The informal sector (IS) comprises all private enterprises owned and operated by individuals or households without legal and regulatory approvals [1], [2]. Typically, these enterprises are operated on a small scale, don't pay taxes, don't receive support from the government fully, may face unfair competition, and don't have access to credit markets [3] [4]. [5] defines that IS are firms with limited ownership (self-employed), utilize unpaid family members, domestic servants, less-educated employees, and have less than five workers (including the owner). The informal economy accounts for a significant contribution to the national economy [4]. The total employment rate is 36.5% in the informal sector that represents 32.3% female and 39.0% male in Fiscal Year (FY) 2017/18 in Nepal [6]. According to the economic survey 2018/19, the employment in the IS is 41% and it is represented by 32.9% of female and 45.8% of male employment. [2] has expressed the factors hindering the growth of informal enterprises are a) internal factors such as limited human capital, lack of working capital, outdated technology, poor location, low level of education etc.; b) external factors such as loosing access to financial services, limited access to business development services, limited markets, poor supply of economic infrastructure and public services, complex and burdensome government regulations, poor business network etc. Therefore, informal businesses operate in complex and competitive environment where they need awareness of their internal and external financial context.

Management accounting has been defined by [7] as a profession that supports management in making the decision, devising planning and performance management systems by providing expertise in financial reporting and control for the formulation and implementation of an organization's strategy. According to [8], managerial accounting provides

information from both inside and outside the enterprise for making decisions. Therefore, management accounting information is very important not just for operational efficiency but also for planning and decision-making to business organizations [9]. Even though informal sector entrepreneurs are an important part of the economy and the labor market in developing countries because they play a major role in employment creation, production, and income generation [10], management accounting practices are very difficult to apply in informal sector entrepreneurs because the majority of informal entrepreneurs are poor, uneducated and unorganized [11]. It has been very difficult to develop/update the statistics of IS entrepreneurs because they are an unregistered and changeable business in Janakpurdham Sub-Metropolitan City. Therefore, since they are not well organized, registered, and educated, how they continue and carry out their businesses, what strategy they follow to survive, how they manage the funds are research questions.

Generally, they confirm that medium-sized firms show higher usage and/or higher sophistication of management accounting systems compared to small firms [12]. Some authors stated that medium-sized enterprises generally use more management accounting techniques and that these are more sophisticated than those of small firms [13]. Other studies found that management accounting systems in medium-sized enterprises are more comparable to those in large than those in small enterprises [14]. Micro-level entrepreneurs were not found to use more sophisticated performance measurement techniques for assessing production and operations performance strategies [15]. Even though micro-level informal sector businesses are important for economic development, our challenge is to know how they can be developed their understanding of entrepreneurship and strategic management. According to [16], management accounting and financial accounting can be a means to strategize informal sector entrepreneurs.

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Objectives of the Study: The objective of the study is to know the use of management accounting information to set the strategy of the informal sector business in Janakpudham city.

Significance of the Study: The significance of the study in emerging markets serves to reinforce the informal sector activities since such activities are a global issue for management and investigation [17]. The percentage of unemployment in province number 2 (where the Janakpudham Sub-Metropolitan City lies) is 20.10 [18]. The contribution of informal sector business for employment is 41% in Nepal [19]. Formalization of the informal sector business is necessary for Nepal since it is challenging to Nepal due to growing large decent work deficits in the informal economy [20]. An unacceptable gap and a major cause of underestimation and inconsistency of informal sector enterprises in National Accounts that needs consideration as a part of the non-observed economy [21]. Therefore, [22] expresses that the interest of the majority of workers can be addressed while the informal sector is organized and formalized. In the formalization of informal businesses, how they perform, what is the chances of sustainability, how they generate money, what is their strategy to sustain have to be studied. Therefore, this research is found significant to gauge the status on the basis of financial sustainability.

2. Methods

This study is based on the qualitative method. A case study method has been applied to study the application of management accounting in the informal business. Four informal sector business has been studied in this research. [23] expressed the features of informal economy in Nepal such as farm and farm-related work, trading (street vendors, hawkers), craft workers (bamboo, wood, metal craftwork), construction workers (builders, carpenters, road builders), transport (porters, drivers, rickshaws, transport helpers), micro-enterprise (family-based shops) and other (barbers, domestic workers). Micro hotel – canteen, a shoe store, a tea shop, and a rickshaw driver have been taken as samples for the study.

Primary data has been collected from the interview with the selected research participants. A semi-structured question was designed and asked question to collect the required information for the study. This study has used simple statistical tools. Research participants of this research are businesses with no formal status. The case of the business model they established and developed in Janakpudham city is has been studied.

3. Results and Discussions

[12] has studied management accounting in SMEs relying on five key themes as management accounting determined by company size, determined by environmental issues, determined by sectorial issues, determined by organizational factors, and adoption of new management accounting

techniques. I have selected micro-level informal businesses which have less than NPR 2 million income per year. The brief characteristics of the selected business are as follows.

Case 1: Canteen (No specific name of the business was given)

A canteen, Mr. Saroj Shah was involved in selling tea, snacks, and lunch to officials for a year at the Mills Area Chowk of Janakpudham. He is being supported by his brother for purchasing the supplies and maintaining the books of account. He has recruited a cooking staff. He has started this business recently but in a planned way. The major items of the canteen are snacks and tea. On the basis of demand, this business manages lunch and dinner too.

Case 2: Shoe store (No specific name of the store was given)

A shoe store, Mr. Ram Janam Sah is selling slippers and shoes for 20 years at Padamchowk of Janakpudham. When he started this business in this place, it was not so advanced. He took the advantage of fewer competitors and continued his business till now. Now it is good to him that he could run his family, arranged the education for his children by the earning of the business. His children have started the job.

Case 3: Tea shop (No specific name of the shop was given)

A tea shop, Mr. Shyam Sundar Shah is running a tea shop for 17 years at Bhanuchowk of Janakpudham. He estimates that about 1000 teacups and light food items are sold in a day. Especially he has to be engaged in the morning and evening hours. Daytime is not a favorable selling time. Mr. Shah runs the business with the support of his family member his son and daughter. During the study period, I observed a huge flow of customers in his business. The customer repeatedly visiting his shop for buying tea and light snacks.

Case 4: Auto-rickshaw driver (No specific name of the business was given)

A rickshaw driver, Buddhan Thakur is operating an auto-rickshaw for 5 years. He invested NPR 300,000/- to purchase it. He serves the passenger from 7 am to 8 pm for earning. Generally, his auto-rickshaw runs within the city every day. He may have a chance to go far away to the city sometimes.

3.1 Analysis

3.1.1. Financial planning and budgetary control

Budgeting helps a firm to decide how to allocate projected revenue. For the success of a business firm, financial planning builds up the competitive strength of a business firm. Every business prepares the plan for the coming year informally. It is not in the written form.

Table 1: Estimated income-expenditure forecast

Particulars	Canteen	Shoe store	Tea shop	Auto-rickshaw driver
Income	100%	100%	100%	100%
Expenditure	70%	67%	44%	43%
Profit	30%	33%	56%	57%

Canteen has estimated highest expenses and the auto-rickshaw driver has estimated the lowest. The profit plan of the tea shop and auto-rickshaw driver is above 50%.

Table 2: Income generating plan

Particulars	Canteen	Shoe store	Tea shop	Auto-rickshaw driver
Sales	93%	87%	97%	96%
Negotiation to supplier	1%	2%	-	-
Credit sales	4%	4%	1%	-
Increase the price	2%	7%	2%	4%

The major activity of each business is sales to generate income. However, canteen and shoe store has a strategy of buying goods at a cheaper rate from suppliers. Another strategy of these businesses to generate more income is to tempt customers by selling products on credit. All businesses are seemed strategic to increase product prices as per the condition such as shortage, immediate supply, extra time service, etc.

Table 3: Estimated expenditure

Particulars	Canteen	Shoe store	Tea shop	Auto-rickshaw driver
Material	43%	70%	50%	17%
Wages	31%	5%	-	-
Maintenance	9%	-	-	67%
Miscellaneous	18%	25%	50%	17%

Informal businessmen estimate the expenses going to be incurred. The canteen owner expects the expenses in buying materials such as stuff, vegetable, fuel, spices, water, etc. Shoe store plan for buying socks, shoes, and slippers. Tea shop plan for buying tea, milk, sugar, paper cups, fuel, etc. Auto-rickshaw driver plan for buying parts. All businesses have seemed an estimation of wages, maintenance, and miscellaneous expenses.

Table 4: Miscellaneous expenses provision

Particulars	Canteen	Shoe store	Tea shop	Auto-rickshaw driver
Credit sales loss	2%	16%	10%	6%
Family	40%	40%	5%	80%
Personal	58%	44%	85%	14%

There are three categories of miscellaneous expenses in informal businesses viz. credit sales loss, family expenses, and personal expenses. As

Table 4 reveals that informal sector businessman already has the provision of such expenses.

3.1.2. Cost accounting

The process of recording, analyzing, and reporting all costs which include both variable and fixed is cost accounting. This supports company management to make better financial decisions, introduce efficiencies, and budget accurately. I found the informal enterprises have been able to determine the cost of goods sold on the basis of the cost they incurred.

Table 5: Variable and fixed cost added with the purchase price of the product

Types of cost	Canteen	Shoe store	Tea shop	Auto-rickshaw
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				driver
Variable cost	Material cost	Material cost	Material cost	Material cost
	Labor cost	-	-	-
	Unexpected expenses	Unexpected expenses	Unexpected expenses	Unexpected expenses
	Transportation cost	Transportation cost		Repair and maintenance
Fixed cost	Rent	Rent	Rent	

3.1.3. Cash flow analysis

How a company spends its money and from where a company receives its money is presented in the statement of cash flow. All cash inflows and cash outflows of a company have to be examined to know the adequacy and shortage of cash for the operational activities. Informal entrepreneurs have no proper idea regarding the components of cash flow statements namely operating activities, investing activities, and financing activities. Also, the cash flow statement can't be properly prepared to test the status in the absence of proper recording in the informal sector business.

Table 6 demonstrates the management of cash by informal entrepreneurs.

Table 6: Management of cash by informal entrepreneurs

Particulars	Canteen	Shoe store	Tea shop	Auto-rickshaw driver
Cash or accrual basis	Cash	Cash	Cash	Cash
Credit sales realization	2 months	1 month	1 month	1 month
Shortage of cash	Sometimes	Sometimes	Sometimes	Sometimes
Reason for the cash shortage	Reinvestment	Family expenses	Family expenses	Family expenses and repair and maintenance
How many rupees of cash are generated for every rupee of sales	Don't know	Don't know	Don't know	Don't know
Free cash flow (CFC) experienced or not	Don't know	Don't know	Don't know	Don't know

3.1.4. Standard costing

Under standard costing, standard costs are pre-determined and actual costs are compared with these costs. The variations between the two are noted and analyzed. The causes of variations are corrected to control the factors leading to unfavorable variations. In this manner, standard costing is thought of as an effective tool for the management in planning, coordination, control, and decision making. Informal entrepreneurs use standard costing methods most effectively in different contexts knowingly or unknowingly. All entrepreneurs examine the favorable purchase price, sales price, quantity, and profit margin.

Table 7 reveals the context of each entrepreneur.

Table 7: Standard pricing practice of informal entrepreneurs

Particulars	Canteen	Shoe store	Tea shop	Auto-rickshaw driver
Different product different method of pricing	Yes	Yes	Yes	Yes
Comparison of a standard with an actual purchase price	Yes	Yes	Yes	Yes
Comparison of the standard with the actual sales price	Yes	Yes	Yes	Yes
The decision of final sales price	Sales price = purchase price + all variable and fixed cost + profit margin			As per market rate
Percentage of profit margin	20%	40%	40%	As per market rate
Strategy to purchase in cheap rate				
Standard price	Low preference	Low preference	Low preference	Low preference
Standard quantity	Nothing	Bulk purchase	Nothing	Nothing
Contractual purchase	Not applicable	Not applicable	Not applicable	Not applicable
Product-wise negotiation	Negotiate	Negotiate	Not applicable	Some special cases

3.1.5. Financial statement analysis and decision-making

3.1.5.1. Financial statement analysis: Financial statement analysis comprises gaining an understanding of the financial situation of the firm by reviewing its financial reports. There are two methods of analyzing financial statements i.e. horizontal and vertical analysis. The results from the analysis are used for decision-making. But I found that the informal sector business has not proper accounting and recording keeping system. Due to this condition, there is not both horizontal and vertical analysis of the financial statement. However, the information collected from the interview can reveal how these businesses decide somehow.

Table 8: Financial status of the business

Particulars	Canteen	Shoe store	Tea shop	Auto-rickshaw driver
Capital	100,000	500,000	200,000	300,000
Profit calculated the previous year		Tentatively	Tentatively	Tentatively
Income statement (previous year)				
Income earned		1,700,000	700,000	600,000
Expenditure incurred		1,200,000	300,000	350,000
Profit earned		500,000	400,000	250,000
Estimated income statement (this year)				
Income	1,000,000	1,500,000	900,000	700,000
Expenditure	700,000	1,000,000	400,000	300,000

Profit		500,000	500,000	400,000
Utilization of profit				
Reinvest		-	30,000	-
Household expenses		100,000	370,000	250,000
Education of children		400,000	-	-
Save and deposit		-	-	-

3.1.5.2. Decision making: Financial accounting keeps track of business operations and provides a snapshot of financial health. Having studied financial statements, a company can make effective decisions. Company management uses managerial accounting information to decide what should be sold and how to sell. These informal enterprises have difficulty in identifying the factors determining the development of the business. But profit plan has been found in line with the historical records. The decision on costing, income generation plan, pricing, and business extension is based on the accounting even though it is not properly recorded.

3.2. Results

Tea shop and shoe store have sustained for more than 15 years. The family of informal sector entrepreneurs is contributed about 70% of their livelihood per year. The research found out that informal sector entrepreneurs are strategic on their own. These entrepreneurs have used planning, budgeting, and costing knowingly or unknowingly. However, such entrepreneurs need to learn the use of financial reports for more strategic sustainability. They need to be coached for recording the financial transactions. The systematic study and use of accounting reports for making the decision and managing the resources can strengthen the business. As [24] expresses the local government has to manage training and coaching activity for capacity building to informal business because these businesses have a positive impact on local economic development.

4. Conclusion

[15] has expressed increasing participation of poor and marginalized people in economic processes is important for pursuing inclusive growth. One of the ways of participation of such people is the involvement of informal sector entrepreneurship. But the informal entrepreneurs must be strong enough. They must be strategic. Research has proved that the majority of informal businesses fail within a few years after start-up due to not being strategic [25]. This research has concluded that informal entrepreneurs operated businesses above 5 years have learned know how to sustain. These businesses are seemed strategic to run the business although they don't have systematic accounting records. However, the strategy they make for the response of immediate action not for the long term. The growth strategy of such businesses has not been observed. For growth and formalization, they have to be nurtured [26]. These businesses need to learn the method of analysis and use of

financial accounting for quality work, timely work, coordination, network building, promotion as [9] expresses. I observed that these businesses have the potential to grow and being strategic if some supports are provided. I recommend that the local government has to develop a capacity-building program for the development of such businesses so that they can be formalized and used as the source of revenue rather than forceful closure and imposing rules.

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