THE IMPACT OF FINANCIAL DECISIONS AND STRATEGY ON SMALL BUSINESS COMPETITIVENESS

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ABSTRACT

This paper examines the financial decisions made by companies, the strategies that organizations follow, the alignment between these two variables, and the relationship of financial decisions to the level of competitiveness. Two hundred two businesses' testimonies in the region of Celaya were analyzed. The results show that most micro and small enterprises make funding decisions in a certain way, apply an intensive strategy, also that their market longevity is low and their level of sales is regular, implying that Mexican companies lack competitiveness, which hampers their development and expansion. The emphasis that companies place on certain financial decisions is not always appropriate for the type of business strategy being implemented. Likewise, companies that efficiently manage their short-term assets and liabilities are more competitive, as evaluated by their longevity on the market.

JEL: M10; G30

KEY WORDS: Small business, competitiveness, strategy, financial decisions

INTRODUCTION

The effect of financial decisions on business competitiveness is a topic that researcher have not yet studied in depth. Despite its importance and the need to adapt financial strategies to an organization's characteristics, few studies have focused on analyzing decision-making and its impact on small enterprises' competitiveness. A business's financial environment is a main factor for the organization's success, especially small businesses forced by financial limitation to be highly efficient in allocating their scarce resources in order to ensure survival and generate profits.

The importance of financial decisions in business is evident, since many of the factors that contribute to failure can be managed properly with strategies and financial decisions that drive growth and the organization's objectives. According to a number of studies (Ibarra, 1995; Van Auken and Howard, 1993) the main causes of business failure are the lack of financial planning, limited access to funding, lack of capital, unplanned growth, low strategic and financial projection, excessive fixed-asset investment and capital mismanagement. Many of these causes of failure are challenges that can be successfully managed with financial strategies developed and implemented by the organization. However, the study of financial decisions has been, for a long time, limited to large corporations, about which extensive research has been published.One of the main features of small businesses is that they do not have useful financial information to make decisions. The information generated is utilized to pay taxes but does not reflect the real situation of the organization. In addition, small businesses do not have specialized personnel with expertise for planning, administration and financial decision-making, and the owner has to make decisions without a solid foundation. Because small-business owners concentrate mainly on obtaining resources for operating expenses, it is difficult to develop financial plans: there is no knowledge of how to implement them, daily problems overwhelm entrepreneur decision-making and the urgency is to solve basic problems in order to generate income. However, this does not imply that financial decisions should not be based on financial planning. Small businesses' problems are very clear in Mexico. Sixty-five percent of small businesses shut down in less than two years, while twenty-five percent survive during this period with a very low probability of development. Although small businesses do not struggle only in the financial area, it represents a central problem that affects their development.

This research paper aims to contribute to the existing knowledge in the field of small and medium sized enterprise (SME) management through the study of financial decisions, strategies and their impact on the development of SMEs. The objectives are: 1) to understand and analyze the major financial decisions made by SMEs; 2) to determine the relationship between financial decisions and the competitiveness level of SMEs; and 3) to analyze the alignment between SMEs' strategies and financial decisions.This document is organized into four sections. The first is an analysis of the literature on business competitiveness and financial decisions. The second section describes the methodology used in the study, specifying the variables used. The results are presented in the third section and the fourth draws overall conclusions.

LITERATURE REVIEW

Business Competitiveness

Although there is not just one conceptualization of competitiveness, several approaches make reference to multiple factors that in one way or another affect the competitive position of companies and/or entire sectors of production. According to the World Competitiveness Report there are three levels of competitiveness: a) Enterprise Competitiveness, which is defined as "the ability to design, produce and market goods and services that are more attractive than the competitors' benefits package" (Chauca, 2003: 30); b) Sector Competitiveness, which implies that a sector offers high returns on investment and is in a strong growth stage; and, c) National Competitiveness, defined as the ability of a nation to provide an economic, political, social and labor environment favorable to organizational development.

According to Porter (1987), competitiveness is the basis of national prosperity, which is determined by the macroeconomic, political, legal and social context, as well as the microeconomic context, i.e. the strategies implemented by individual organizations. A firm's competitiveness has important implications, positive or negative, for sectors and countries. "The success or failure of a company has an impact on the results of the entire industry; in turn, the firm's performance determines the competitiveness of regions and nations by influencing variables such as employment levels, the rate of economic growth, and ultimately, the level of well-being of people" (Arroyo and Berumen, 2003: p. 13).

However, although the competitiveness challenge lies in the corporate sector, where the company must build technological, marketing, management and human capital, as well as financial capabilities, the involvement of the government is also crucial for the development of business competitiveness. Governmental policies and institutional support help to develop enterprise competitiveness by generating a stable macroeconomic environment, establishing a strong export strategy, promoting the development of industrial clusters and providing efficient infrastructure, among other contributions.

Regarding enterprise competitiveness, Anda (1996) argues that the ability to remain in the environment is a signal that the organization is competitive; in other words, the firm has the ability to compete in a market. To this end, the company must develop various functions in their operational and strategic activity with quality and efficiency in order to be competitive.In this sense, Porter (1987) argues that competitive strategy generated by the organization is what determines business competitiveness, and that the choice of this strategy is based on the structure of the business sector where the organization competes and on the relative position that the organization has within that sector. This means that the strategies implemented by an organization will determine its competitiveness, and they must be carefully selected to give the organization a competitive advantage.

Financial Decisions

One area that has received little attention in the establishment of strategies, especially in the study of micro, small and medium-sized enterprises, is that of financial decisions, even though it is a determinant of business competitiveness. Financial analysis and planning, which represent basic features that support organizational strategy, are nonetheless virtually non-existent in micro and small enterprises, which impose a constraint on the kind of financial decisions businesspeople can take.Financial strategy represents a path to achieve and maintain business competitiveness and position a company as a world-class organization. Financial strategies are goals, patterns or alternatives designed to improve and optimize financial management in order to achieve corporate results (López, 2006).

Financial strategy consists of three interrelated kinds of decisions: investment, funding and working-capital decisions (Ross, Westerfield & Jordan, 2000). Investment decisions relate to the allocation of capital to carry out investment opportunities that are valuable (bring value) to the company, taking into account the magnitude, opportunity and risk of the future cash flows of investment. Funding decisions concern the specific mix of long-term debt and capital that the company uses to finance its operations, i.e., optimal capital structure. Working-capital decisions include the management of short-term assets and liabilities in a way that ensures the adequacy of resources for company operations. Assuming the corporate aim is to maximize profits, it is important for businesses to seek the optimum combination of the three kinds of financial decisions.Mallette (2006) argues that an organization's financial strategy is so important to the company that it must be evaluated and adjusted as frequently as the operational strategy. He also says that the evaluation of financial strategies must be consistent with operations, needs and specificities of the business. The description of financial practices carried out by businesses represents an issue that has received more attention. Valencia et al. (2006) published a study of financial practices in Mexican firms taking into account the organizations' characteristics. They found that most enterprises establish an optimal leverage ratio, use investment evaluation techniques, have traditional management based on budgets and the Return on Investments (ROI), do not use techniques such as EVA or BSC, and apply financial ratios as a technique to analyze profitability.

Jog and Srivastava (1994) conducted a study that looked at financial decision-making processes that Canadian companies followed, as well as techniques they used to make decisions on capital budget, financing costs and sources, and dividends. Their results show that investment decisions are closely related to funding opportunities, and that the method used for the capital budget is the internal rate of return and the net present value. They also found that most Canadian companies determine an optimal debt and equity ratio. With regard to dividends decisions, present and future earnings represent the most relevant factors enterprises consider when deciding on dividend policy.

Another group of studies analyzed firms' use of certain financial analysis techniques. Lazaridis (2002) and Pohlman et. al. (1988) investigated the way in which companies generate information to calculate cash flow, finding a large number of companies using subjective methods to forecast cash flows and just a few companies adopting sophisticated techniques. Kamath (1997) studied long-term funding decisions in large corporations and found that most companies do not maintain an objective in their debt and equity structure, preferring a financial hierarchy. They also showed that the main issues in financing decisions are those related to maintaining financial flexibility and ensuring survival in the long term. Zopounidis and Doumpos (2002) examined a technique called "Multi-criteria decision Aid" (MCDA) that helps with financial decision-making, by evaluating aspects such as corporate performance, investment, financial problems and credit; the authors showed the advantages of this technique in financial decision-making.

Likewise, there has been research focused on the analysis of financial decisions and their impact on creating value for investors. Escalera and Herrera (2006) studied the relationship between financial decision-making and economic value creation in Mexican companies. They found that companies that use supplier financing are more likely to create economic value as long as they do not have collection problems, and that investment decisions must take inventory into account. However, their study is based on small-business owners' perceptions of the importance of decisions, leaving aside the study of variables such as business performance and competitiveness when carrying out financial strategies.

It is evident that most studies have focused on the analysis of the techniques used to make financial decisions rather than on the decisions themselves and their impact on competitiveness. This shows that corporate finance research has not taken into account small businesses' financial decisions. Likewise, researchers have not focused their attention on the study of organizational alignment strategies and financial decisions, to determine the consistency of entrepreneurs' decision-making about capital management and the strategic objectives to follow in order to compete in the market.

DATA AND METHODOLOGY

To develop this research, a random sample of 202 companies was used. The research technique used was the personal interview in order to obtain high quality, in-depth, detailed information. A questionnaire based mainly on 30 questions was used as a research tool. The analysis was based on three main questions: About your company's finances, what problems did you have, how did you solve them and what problems have not been solved? What are the strategies you have implemented? With regard to sales, what problems did you have, how did you solve them and what problems have not been solved? In addition, information about company age and size was used. The SPSS 16.0 statistical program was used for information analysis.Three hypotheses guide the research work. The first hypothesis deals with the main financial decisions business owners take in order to learn about the capital management underlying their operations. Major financial decisions might be expected to focus on financing and working-capital decisions, as the Mexican SMEs are characterized by lack of capital to support the day-to-day operations of the company. Therefore, the first hypothesis holds:

H1: SMEs' main financial decisions are about financing and working capital.

The second hypothesis considers financial decisions and their relation to the level of business competitiveness. In this sense, SMEs that have the ability to obtain funds would be expected to be the most competitive since they manage to secure the capital necessary for business operations (short-term) and to carry out investment projects.

H2: SMEs' that make funding decisions have higher competitiveness than businesses that only make working-capital and/or investment decisions.

The third hypothesis refers to the alignment between the financial decisions and business strategies that businesspeople implement. SMEs might be expected to make financial decisions that support competitive strategies; however, SMEs´ mortality rate suggests that deficient management of financial capital is one of the main causes.

H3: SMEs' financial decisions and business strategies are not aligned.

Financial decisions, strategies and business competitiveness measures are shown in table 1. The statements were analyzed and interpreted based on these variables.

Table 1: Measures

Variables	Classification	Definitions	Sub-Classification
Financial Decisions	Investment Decisions	Decisions focused on investing in an asset to generate satisfactory economic benefit in the short or long term.	
	Funding Decisiones	Decisions focused on obtaining resources for investment or for the operation of the organization.	• Bank • Savings Banks • Others (relatives, friends)
	Working-capital Decisions	Decisions focused on short-term assets and liabilities such as terms and conditions of sale, payment, inventory, cash, etc.	
Business Strategies	Integrative	Strategies to complement and/or acquire greater control over all activities relating to firm's supply chain	
	Intensive	Strategies focused on achieving better product position on the market and making the market grow.	
	Diversification	Strategies focused on introducing new products or product lines in the same or another market.	
	Others	Alliance strategies with any other company; liquidation strategies or reduction strategies that focus primarily on restructuring through cost-reduction strategy.	
Competitiveness	Sales Level	High level of sales: company is satisfied with sales amount, high number of customers, and high or low seasons do not affect sales. Medium level of sales: company is fairly happy with their sales because they depend on high seasons. Sales are not very constant. Low level of sales: company is not satisfied with sales because they are low. Lack of customers.	
	Firm age	• 1 to 10 years • 11 to 19 years • 20 years or more	

This table shows the definitions of the three main variables we analyze in our study.

EMPIRICAL RESULTS

Of the companies included in the sample, 91% are small and micro, 8.4% are medium and only 1% are large, making the sample composition similar to the distribution by size of enterprises at the national level (Mexico).The first hypothesis considers the companies' main financial decisions. 28.2% of the companies make investment decisions, 33.7% decide on working capital and 38.7% make funding decisions. This implies that few companies make investment decisions. They focus more on short-term working-capital decisions, where internal dynamics and the organization's operations require an analysis of payment terms and conditions, collection, inventory volume and cash management. Likewise, the results show that the most frequent decision in the organization is about funding, since the company is obliged to analyze the amount, conditions and sources of funding available to meet its obligations, generally short-term.

Table 2: Frequency of Financial Decisions

		Frequency	Percent	Cumulative Percent
Valid	Investment	57	28.2	28.2
	Funding	77	38.1	66.3
	Working-capital	68	33.7	100.0
	Total	202	100.0	

This table shows the frequency of the three types of financial decisions. Funding decisions are the most common.

The most common source of financing is relatives or friends, with 18.3%; 8.9% borrow from savings banks due to the less stringent requirements and the low interest; only 4% of organizations ask for financing from banks due to the stricter requirements, high interest rates and occasionally to bank policies that do not consider most SME's to be creditworthy.The second hypothesis examines the relationship between financial decisions and the level of business competitiveness. The level of organizational competitiveness was determined on the basis of sales and the businesses' capacity to survive in the market. 29.2% of the companies have a low sales level, 42.6% have a medium level and 28.2% have a high level (see Table 3).

Table 3: Sales Level Distribution by Percentage

		Percent	Cumulative Percent
Valid	High	28,2	57,4
	Medium	42,6	100,0
	Low	29,2	29,2
	Total	100,0	

This table shows the relative frequency of the sales level, which measures organizational competitiveness.

Because sales are generated in a variable environment, several business owners mentioned that their medium level of sales is due to seasonality of their products, since sales peak in certain seasons, but drop off considerably in others. Other business owners with *low sales* argued that this situation is due to the high levels of inflation, which generates an increase in the raw price and sales cost, and therefore reduces the level of consumption; still others blame *poor organization of their personal finances* and a lack of customers. Companies with good sales levels considered that good planning and management, offering sales on credit, investing in new products, reducing costs, purchasing in cash in order to get a better price and product availability are the key elements to increase sales.

As for the relationship between financial decisions and competitiveness level as measured by sales (Table 4), of those companies considered competitive (good sales level), 35% make decisions about financing, 33% about working capital and 32% about investment. The results show that the level of an organization's competitiveness is not related to a specific type of financial decision; however, it can be said that the most competitive companies emphasize funding decisions.

Table 4: Relationship Between Financial Decisions and Sales Level (competitiveness)

Financial Decisions/ Sales			Sales			Total
			High	Low	Medium	
Financial Decisions	Investment	Count	18	18	21	57
		% within Sales	30.5%	31.6%	24.4%	28.2%
		% of Total	8.9%	8.9%	10.4%	28.2%
	Funding	Count	22	20	35	77
		% within Sales	37.3%	35.1%	40.7%	38.1%
		% of Total	10.9%	9.9%	17.3%	38.1%
	Working-capital	Count	19	19	30	68
		% within Sales	32.2%	33.3%	34.9%	33.7%
		% of Total	9.4%	9.4%	14.9%	33.7%
Total		Count	59	57	86	202
		% within Sales	100.0%	100.0%	100.0%	100.0%
		% of Total	29.2%	28.2%	42.6%	100.0%

This table shows the relationship between financial decisions and organizational competitiveness measured by sales level. There is no significant relationship between these variables.

If we consider a company's success in staying on the market as a variable of competitiveness, the results are different. At first, it is important to know that 46.5% of the companies have been on the market for between one and ten years, 21.3% between 11 and 19 years, and 32% more than twenty years .Table 5 shows that of the longest-lived (most competitive), 44.6% focus on working-capital decisions, 33.8% on funding decisions and 21.5% on investment decisions. If we evaluate companies that have remained between 11 and 19 years on the market, data show that 42 percent have taken funding decisions, 39.5% working-capital and 18.6% investment decisions. In this regard, organizations focused on investment decisions are those that have the fewest years on the market (61.4%), while organizations that focus on working-capital decisions are those that have managed to compete for more than 20 years. This may imply that efficient management of working capital is one of the essential decisions for the organization's survival as it relates to short-term assets and liabilities, those being the main financial difficulties that organizations face.

Table 5: Relationship Between Financial Decisions and Firm Age (competitiveness)

Financial Decisions			Firm Age (in Years)			
			1-10	11-19	More Than 20	Total
Decisions	Investment	Count	35	8	14	57
		% within FinanDecis	61.4%	14.0%	24.6%	100.0%
		% within FirmAge	37.2%	18.6%	21.5%	28.2%
		% of Total	17.3%	4.0%	6.9%	28.2%
	Funding	Count	37	18	22	77
		% within FinanDecis	48.1%	23.4%	28.6%	100.0%
		% within FirmAge	39.4%	41.9%	33.8%	38.1%
		% of Total	18.3%	8.9%	10.9%	38.1%
	Working-capital	Count	22	17	29	68
		% within FinanDecis	32.4%	25.0%	42.6%	100.0%
		% within FirmAge	23.4%	39.5%	44.6%	33.7%
		% of Total	10.9%	8.4%	14.4%	33.7%
Total		Count	94	43	65	202
		% within FinanDecis	46.5%	21.3%	32.2%	100.0%
		% within FirmAge	100.0%	100.0%	100.0%	100.0%
		% of Total	46.5%	21.3%	32.2%	100.0%

This table shows the relationship between financial decisions and organizational competitiveness measured by firm age. The results show that firms focused on working-capital decisions have managed to survive more years in the market.

The third hypothesis considers the relationship between financial decisions and business strategies. According to table 6, intensive strategies, which relate to the development of products and market, are the most commonly used in most companies (52.5%); entrepreneurs want to make their products known through advertising, and give good service to customers to expand their market (many businesses owners choose the intensive strategy because they do not need much capital to deploy it).

19.8% of the companies use integrative strategies, which focus on developing a proper supply chain in order to achieve greater control over distributors, suppliers, and/or competitors. This involves contacting larger suppliers, developing better relationships within the supply chain and contacting wholesale buyers for the positioning of the product, among other tactics.

Diversification strategies are only implemented in 13.9% of the sample, as are the strategies of liquidation, reduction or partnerships. Reluctance to implement such strategies could be due to low economic capacity to introduce new products, whether they are related to current products or not, as well as to the risk involved in introducing them.

Table 6: Frequency of Strategy Types

		Frequency	Percent	Cumulative Percent
Valid	Integrative	40	19,8	19,8
	Intensive	106	52,5	72,3
	Diversification	28	13,9	86,1
	Others	28	13,9	100,0
	Total	202	100,0	

This table shows the frequency of strategy types. Intensive strategies are the most common.

Table 7: Relationship between Financial Decisions and Strategy Types

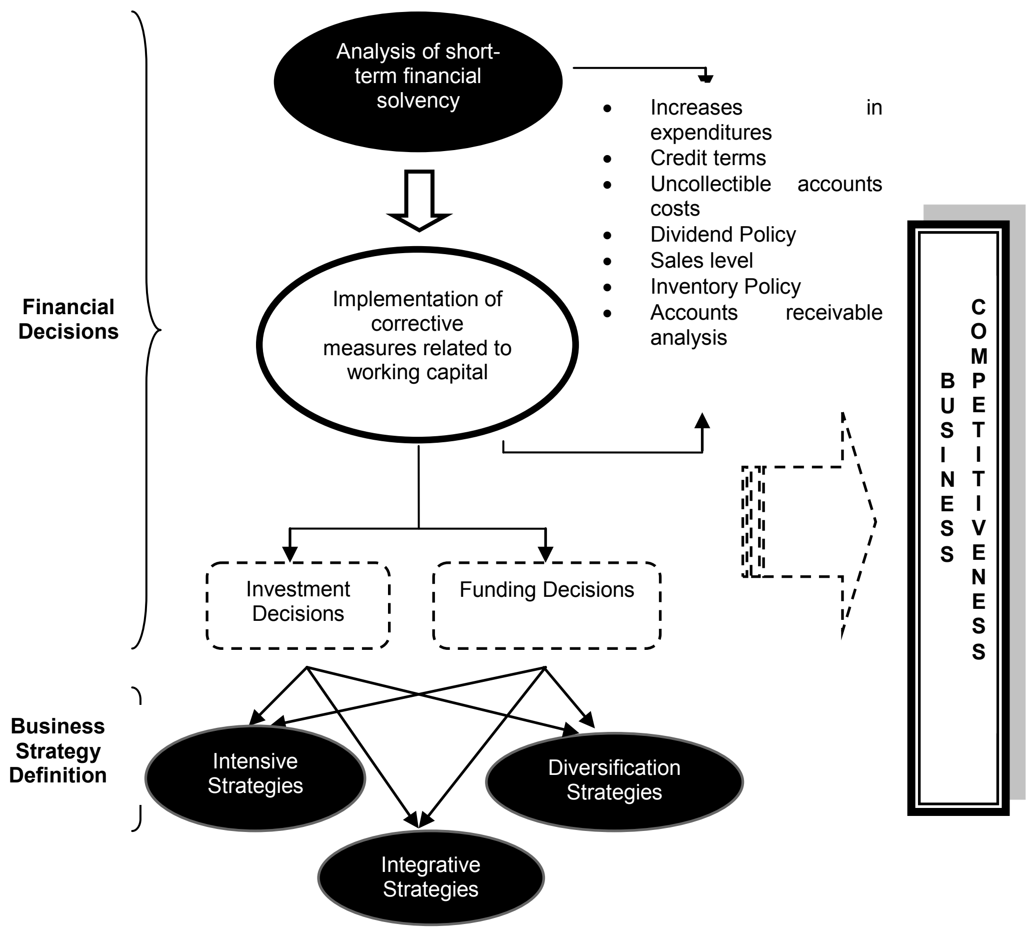
			Strategy				
			Integrative	**Intensive**	**Diversification**	**Others**	**Total**
Financial Decisions	Investment	Count	11	31	6	9	57
		% within FinanDecis	19,3%	54,4%	10,5%	15,8%	100,0%
		% within Strategy	27,5%	29,2%	21,4%	32,1%	28,2%
		% of Total	5,4%	15,3%	3,0%	4,5%	28,2%
	Funding	Count	13	40	13	11	77
		% within FinanDecis	16,9%	51,9%	16,9%	14,3%	100,0%
		% within Strategy	32,5%	37,7%	46,4%	39,3%	38,1%
		% of Total	6,4%	19,8%	6,4%	5,4%	38,1%
	Working-capital	Count	16	35	9	8	68
		% within FinanDecis	23,5%	51,5%	13,2%	11,8%	100,0%
		% within Strategy	40,0%	33,0%	32,1%	28,6%	33,7%
		% of Total	7,9%	17,3%	4,5%	4,0%	33,7%
Total		Count	40	106	28	28	202
		% within FinanDecis	19,8%	52,5%	13,9%	13,9%	100,0%
		% within Strategy	100,0%	100,0%	100,0%	100,0%	100,0%
		% of Total	19,8%	52,5%	13,9%	13,9%	100,0%

This table shows the relationship between financial decisions and the type of strategies implemented by firms.

When the relationship between strategy types and financial decisions is analyzed (table 7), the results show that of the total number of companies implementing integrative strategies, 27.5% make investment decisions, 32.5% funding decisions and 40% working-capital decisions. It would be expected that enterprises wanting to achieve greater integration with distributors or suppliers must plan and manage needed investments to carry out integration actions like purchasing transportation equipment or machinery to produce raw material. However, the results show that most companies do not plan their investments and focus primarily on working-capital decisions.

Regarding intensive strategies, the results show that 29.2% make investment decisions, 37.7% funding and 33% working-capital decisions. When an organization implements strategies to achieve greater market penetration, product improvement or new market development, it needs to focus primarily on funding and investment decisions, and then on working capital. The results show a balance in financial decisions.In order to implement diversification strategies, greater analysis of investment decisions (21.4%) and funding (46.4%) would be expected. However, data show that nearly 33% of companies focus on working-capital decisions. In this sense, we can say there is no alignment between business strategies and financial decisions; this means that financial decisions do not support the strategies' implementation.Based on the results of this investigation, the following model is proposed for financial and strategic decision-making. The model shows that it is important to analyze and solve issues related to working capital, which is the basis for business development. Once the company has generated corrective proposals to improve short-term financial solvency, it is in a position to make decisions regarding both investment and financing, depending on the strategies that it has defined as part of its strategic planning.

Figure 1: Decision Making Model- Business Strategies and Financial Decisions



The figure shows a decision-making model where financial decisions and business strategies must be aligned in order to obtain business competitiveness

CONCLUSIONS

Currently the business environment is complex and dynamic, requiring a greater capacity for adaptation if businesses want to be competitive. A business role that has regained importance is financial resource management due to the need to make more efficient use of the resources companies possess. In this sense, there are three fundamental categories of decisions that any organization should consider as necessary no matter what its size: working-capital decisions, investment decisions and funding decisions.The main objective of this study is to examine financial decisions and business strategies implemented by Mexican organizations, as well as their relationship to competitiveness. Researchers interviewed 202 business people encoded the information based on discourse' analysis and variables definition.

Results show that most micro and small enterprises make funding decisions and apply an intensive strategy (development of products and market); their ability to survive in the market is low and sales are at the medium level, implying that Mexican companies lack a high degree of competitiveness, which hampers their development and expansion at all levels. We found that companies that efficiently manage their short-term assets and liabilities are more competitive (company's success in staying on the market as a variable of competitiveness). In addition, the results show there is no alignment between business strategies and financial decisions; this means that financial decisions do not support the strategies' implementation.In order to raise business competitiveness, business owners need to adopt strategic management where objectives are proposed and actions are implemented. If there are no objectives from the outset, it becomes very difficult to formulate a competitive strategy, regardless of the firm's size. Likewise, the business owner must know and analyze the financial decisions that affect the organization's development in order to obtain an alignment between organizational goals and financial decisions and thus enhance the company's growth. There are diverse factors over which the small-business owners have the ability to attenuate and prevent the negative effects of financial difficulties.

Businesspeople must have sufficient financial support to sustain organization operations while achieving the breakeven point; otherwise, development potential decreases due to lack of capital. No matter what their organization's size, owners must begin to generate financial-accounting information to fulfill bank financing requirements. When businesses have financial information, they are also able to analyze investment needs (considering cost-yield) to determine the optimal capital structure, to set dividend policy and to define funding strategy. It is also necessary to apply cash management techniques and establish credit policies and inventory policies through the analysis of the organization's operating cycle. With these actions, owners can have greater success in dealing with financial difficulties; however, they must be aware that there are externalities such as macroeconomic conditions, interest rates, the international environment, weakness of internal market, rising prices, inflation, exchange rate, among others, that can influence business performance.

The study of Mexican SMEs presents difficulties especially when we talk about finance because businesspeople neither have nor want to offer financial information, even for academic purpose. In this case, the information on sales level as a variable to measure competitiveness has its limitations as it is based on business people's perception of their sales.Future research needs to analyze the relationship between business strategies and financial decisions in specific industries, in such a way that the design of decision-making models considers their specific characteristics and problems, as well as their externalities, as factors that impact organizations' performance.

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