

Full Length Research Paper

The impact of financial crisis on profitability, asset turnover and state aid in SMEs

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The role of small and medium companies (SMEs) in Spain in terms of economics and job creation is highly relevant in order to escape from the global financial crisis in which the world is immersed. This paper seeks to examine and quantify the impact of this crisis in the Spanish SMEs, analyzing the results of a survey in a representative sample of that particular business sector. The survey was conducted to discover various economic and financial issues, and draws results such as the high impact of the crisis in terms of profitability, fall in demand and assets turnover, and the need to increase State aids to SME.

Key words: Small and medium companies (SMEs), global financial crisis, State grants, economic recovery, profitability, management.

INTRODUCTION

According to data issued by the general direction of policy of small and medium companies (SMEs), these companies have a significant importance in the Spanish case, as they create about 80% of total employment generated by the Spanish economy globally. SME also represent an important part of all economies in the European Union in terms of number of jobs offered, reaching 66.7% of total employment in the non-financial business economy sector.

Another important factor to consider in the area, apart from the amount of employment generated, is the quality of employment created (Birch, 1979; Suárez, 1994; Robbins and Coulter, 2000; Aguirre et al., 2003). Thus, the employment generated by the Spanish SME is configured as extremely important in terms of job creation, having 75% of fixed-term contracts in the cases studied. This means three out of four jobs created by these companies are of high quality, provides more stability for workers and letting the country escape from "garbage" employment generation that is derived from the

frequent temporary contracts currently developed by companies of greater size, with the subsequent economic, social and labor problems, from the worker or employee point of view (Cabanelas, 1998; Bueno et al., 2002; Gorostegui, 2004).

Also, it is possible to ensure that smaller firms or micro enterprises are the largest contributors to maintain stability in employment in different phases (Churchill and Lewis, 1984; Fuller, 1996; Reid, 2007; Stangler, 2009; Battisti and Deakins, 2010) of economic cycle - expansion, recession, deceleration and recovery- with the disadvantage that workers belonging to this specific type of small size companies have a lower average wage in relation to larger companies (Díez de Castro and Redondo, 2002; Bueno, 2004).

SMEs in Spain show a smaller average size compared with the standard sizes of the European Union. Also, in Spain, there is a greater spread between the average sizes of each segment analyzed. Despite this, from the data collected and published by the general direction of policy of medium and small companies, it can be concluded that these companies in Spain have grown moderately and have increased in size over the past 10 years and, therefore, have reduced distances between their average relative sizes.

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In particular, micro companies use for their activity, an average of four workers - being three-quarters of them permanent workers -, small companies use, on average, nineteen workers - eleven of them with long term contracts -, medium firms often use an average of forty-seven workers, and finally, large corporations use, on average, around two hundred and thirty-seven workers, being in the last two cases analyzed, mostly temporary jobs (Navas and Guerras, 1998; Bateman and Snell, 2001; Dasi et al., 2006).

In this regard, making comparative analysis of the business environment integrated into the European Union (EU), the sizes of the different types of companies by number of employees are relatively larger than in the Spanish case. More specifically, in the concrete business referred, the number of employees, on average, is two hundred and forty nine for midsize companies, forty-nine workers for small companies and, finally, nine workers for microenterprises (Domínguez, 1995; Dubrin, 2000; Daft and Marcic, 2006).

Thus, the aim of this paper is to analyze the impact of the current financial crisis in the evolution of the economic and financial profitability, the fall in demand for goods and services of Spanish SME and the importance of direct and indirect aids from the public sector for these companies.

MATERIALS AND METHODS

The total number of companies in Spain in the year 2010 is 3.291.263. According to the guidelines of the European Union, for whom a small or medium company is a firm whose number of employees vary from 0 to 250, and whose turnover is below 40 million-euro, 99.9% of the total number of Spanish companies quoted previously, that is, 3.287.944, are small or medium companies.

The questionnaires (Dillman, 2000) were mailed to the respective registered offices of the selected sample of 1.264 medium and small companies belonging to all the Autonomous Communities in Spain along the first week of February 2010, with the express understanding that they should be answered by the managers of the selected company, as well as specific details of the study to be performed, instructions for completion, authors, purpose and response date within two months. 63% of the questionnaires were filled and received by the end of April 2010. At that moment, the data began to be quantified by the authors.

Questionnaire

The questionnaire was prepared and developed by a group of experts throughout the month of January 2010 and the questions included were:

1. What has been the negative impact of financial crisis on demand for goods or services offered by your company in the period 2008 to 2009?
2. What has been the negative impact of economic and financial crisis on the operating profitability of your business in the period 2008 to 2009?
3. What has been the negative impact of economic and financial crisis on the financial profitability of your business in the period 2008 to 2009?

4. What has been the negative impact of economic and financial crisis on the EBIT of your company in the period 2008 to 2009?
5. What has been the negative impact of economic and financial crisis on the pre tax profit (EBT) of your company in the period 2008 to 2009?
6. What has been the negative impact of economic and financial crisis on the net profit of your company in the period 2008 to 2009?
7. Has the economic and financial crisis led to increased difficulties in financing your business?
8. Has the economic and financial crisis led to increased liquidity problems in your company?
9. What has been the negative impact of economic and financial crisis on the total debt volume of your business?
10. What has been the negative impact of economic and financial crisis on the volume of long-term debt of your company?
11. What has been the negative impact of economic and financial crisis on the volume of short-term debt of your company?
12. What has been the impact of economic and financial crisis on the assets turnover of your company in the period 2008 to 2009?
13. Do you think it is essential to increase or enhance the provision of direct or indirect aids from the state to your company in order to overcome the current economic crisis? If so, indicate which ones.

The first six questions, as well as questions number nine, ten and eleven, were closed questions with five options: zero, low, medium, high and very high. On the contrary, questions number seven, eight, twelve and thirteen were open, allowing freedom to answer to the respondent.

RESULTS

The results for questions number 1, 2, 3, 4, 5, 6, 9, 10 and 11 are shown in Table 1. With respect to the seventh question, the overall impression is that the crisis has led to increased difficulties in financing these small and medium businesses, as 81% of the surveyed companies claim that they faced important problems. Another 16% believe that the impact in reaching this finance had been low or medium, while only the remaining 3% said that there was no significant influence on this matter (Figure 1).

In relation to the eighth question of the questionnaire, if the economic and financial crisis led to increased liquidity problems in your company, 74% of the respondents said that the crisis had clearly increased them, with 21% answering the impact in cash had been low or moderate and 5% affirming that there had not been significant influence on it (Figure 2).

The twelfth question analyzed the impact of economic and financial crisis on the asset turnover of the company in 2008 to 2009. Thus, 59% of the companies claim that the turnover of assets in its business has increased dramatically as a result of the reduction of the overall business investment resulting from the decline in domestic demand, 33% believe that the rise in asset turnover has been low or moderate and the remaining 8% said that the asset turnover has not been influenced by the drop in demand following the economic crisis (Figure 3).

Finally, to the last question of the questionnaire, 85% of respondents said they consider the direct or indirect aid

Table 1. Answers for questions 1- 11.

Question	Very high (%)	High (%)	Medium (%)	Low (%)	Zero (%)
1	55	38	6	1	
2	61	34	4	1	
3	69	27	3	1	
4	67	26	5	2	
5	76	21	2	1	
6	72	23	3	1	1
9	79	17	2	1	1
10	52	32	12	2	2
11	86	10	3	1	

Financing problems

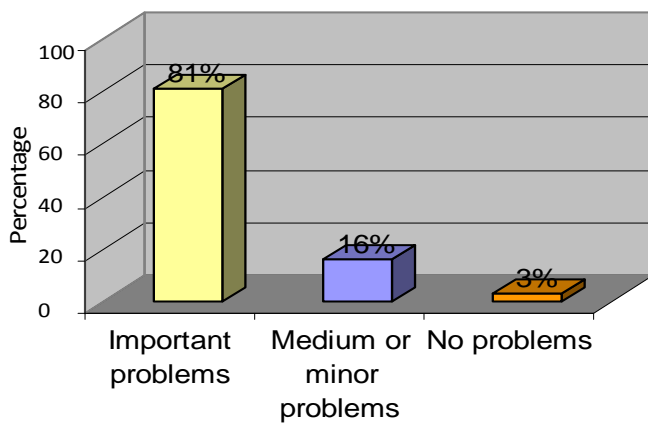


Figure 1. Answers for question 7.

from the state to the business was needed, 7% say the opposite and the rest are not clearly defined in favor or against. Between supporters of increased state aids, 77% opt for direct state grants and the remaining 23% prefer the indirect aid in the form of subsidies or tax relief.

DISCUSION

This study suggests that the intensity of the financial crisis was a major setback for the consumption and investment at the macroeconomic level, as it is reflected in the results of the first four questions. The gradual decline in global demand has led to very negative consequences for the segment analyzed (Muslumov, 2005). For example, and for the time period considered, there is a significant decline in the economic profitability as a result of a sharp decrease in demand for goods and services resulting from the domestic and international recession, which has the main negative consequence of worsening profit margin on sales, gross operating profit and EBITDA (Barroso, 1996; Brealey and Myers, 2008).

Liquidity problems

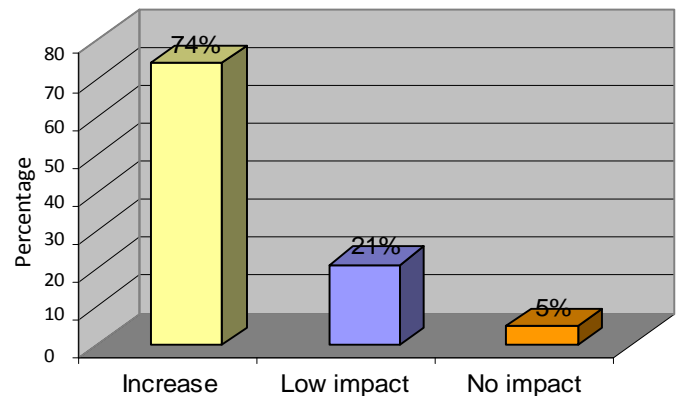


Figure 2. Answers for question 8.

It has also been noticed that there is an increase in asset turnover of the companies analyzed as a result of a decrease of the overall investment in the business resulting from the decline in domestic demand, in line with previous research (Durbán, 1994). However, the positive effect of reducing asset turnover ratio has been insufficient to offset the negative impact of falling demand on the volume of sales and turnover of the companies under study, so, the final effect on the return on assets (ROA) of this specific type of companies has been negative (García Gutiérrez et al., 1989; Schroeder, 1992).

The fall in profitability of the business assets has had a negative impact on financial performance before and after taxes, possibly as a result of two interrelated factors; on the one hand, the obvious reduction of business-economic benefit due to falling sales, and on the other, its negative impact on the net profit (Hellriegel et al., 1998; Qian, 2002).

Moreover, the decline in return on equity (ROE) might also have its explanation in the huge increase in financial costs that these kinds of companies have had to face. This might be as a result of a significant increase in the

Impact of crisis on the assets turnover of the company

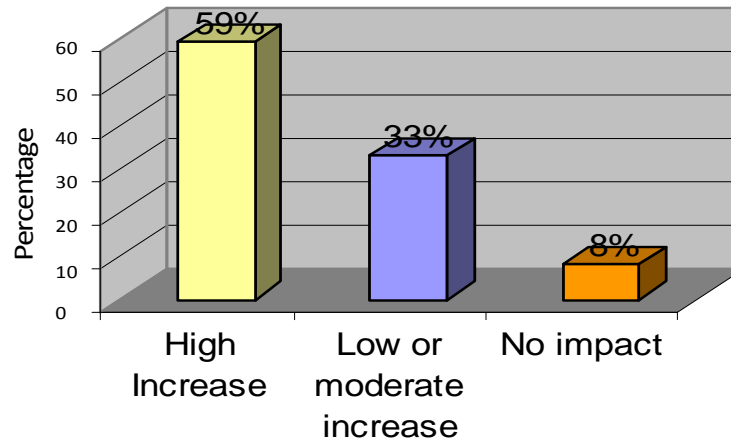


Figure 3. Answers for question 12.

volume of short and long term borrowing, which could not be compensated with the gradual reductions in interest rates and could have an especially negative impact in SMEs (Fernández Pirla, 1994; Hall et al., 2000). The decline in net profitability of the companies under study in this paper has been a key explanatory factor for the increase in funding from current liabilities, especially short-term debt, by reducing the volume of equity in all tested companies, as a result of the collapse of global business results (García and Casanueva, 2002).

Finally, decreases in operating profit and net profit and its negative impact on profitability in the surveyed companies resulted in increased financial risk and, ultimately, in an increased risk in the global business (Gómez-Mejía et al., 2005) which could be mitigated with direct and indirect aid from the state sector, as it is suggested from the results of question number five.

The impact of the crisis has been high in relation to difficulties of SME in obtaining funding for their businesses, which has caused liquidity pressures in the short term that the companies have tried to solve with short-term external financing; this is the reason why the short-term debt increased to a greater degree than long-term debt. This increases the risk of liquidity or short-term solvency of the SME, being all this confirmed by the exponential increase of bankruptcies of SME during the period analyzed.

The recommendations to increase profitability could be to faster and boost sales - through trade policy, marketing -, reduction and control of fixed costs or its transformation into variables, wage moderation and efficient management of assets, avoiding excess capacity or oversized SME, apart from the State aids suggested in the

conclusions of this paper.

Conclusions

This article has examined the effects of financial crisis on the evolution of demand, financial and economic performance, the volume of investments and the need for public support for the business sector that includes, combines and integrates the Spanish SMEs in recent years.

Thus, it can be concluded that declines in economic and financial profits and its negative impact on economic and financial profitability ratios of the SMEs analyzed, results in increased economic and financial risk of the SMEs analyzed, and finally, it results in an increased overall risk of the company. This has resulted in a significant increase in the total number of legal cases taken to the courts in the form of defaults or bankruptcy proceedings in Spain that have increased exponentially by more than 300% during the time period considered, which supports the main conclusions arising from this research. This research also shows an effective measure of the impact that economic and financial crisis has had, in the Spanish case, in terms of profitability and overall business risk for the specific set of institutions analyzed.

Moreover, it can also be suggested the need for a development by the Spanish State, according to the time, material and budgetary policies constraints, of an active encouragement of SMEs, since they represent a relevant support for the overall job creation, both in quantitative and qualitative terms, especially in an international scenario like the current deep economic and financial

crisis. SMEs tax benefits in the form of tax credits, the granting of subsidies or direct financial support for the creation and development of business projects, approval of soft loans with preferential interest rates or lines of public funding through the Official Credit Institute (ICO), may be some examples of this government policy to lead to a process of economic recovery.

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