

Specifics of Risk Management for Small and Medium Business Enterprises

Bayan Yermekbayeva and Raigul Doszhan

Al-Farabi Kazakh National University, Almaty, Kazakhstan

Abstract: Risk management is an extremely important element among the activities of small and medium-sized enterprises ("SMEs"). It is necessary for SMEs to be able to effectively manage risks to survive in highly competitive and post-crisis era conditions. Although there are positive dynamics of growth in the number of SMEs in Kazakhstan, statistics show unprofitability in their activities. This article addresses the problems of SMEs in the sphere of trade, manufacturing, construction and services, which have been studied by the author in recent years and considers the role of external consultants in the risk management activities of SMEs.

Key words: Small and medium enterprises • Enterprise risks • Problems of small and medium businesses • Risk management stages

INTRODUCTION

SMEs have a significant place in the modern Kazakh economic system. Such enterprises have certain competitive advantages such as smaller capital intensity in comparison to large businesses, the possibility of organization of production in shorter time-frames and lower requirements for technical, labor and natural resources.

But although SMEs occupy an important role in the economic system of the Republic of Kazakhstan, the impact of SMEs on the cumulative economic processes is not as great as in most developed and developing countries. Nevertheless, the significance and contribution of SMEs is increasing every year. They:

- Replenish revenues of budgets of different levels, -create new workplaces in the country, -contribute to the formation of a competitive environment, the establishment of market equilibrium,-represent a powerful social stratum, a real and serious economic force and
- Provide considerable tax revenues in the budget.

Main Part: In EU countries, SME's employ about 50% of the population, in the USA – 53%, in Japan – 72% and in Kazakhstan SMEs employ 30% of the active population. [1].

In Kazakhstan the Civil Code defines entrepreneurship: "Entrepreneurship is an initiative activity of citizens and legal entities, regardless of ownership, directed toward receiving net income by meeting the demand for goods (works and services), based on private ownership or the business of a state enterprise. Entrepreneurial activity is carried out on behalf and at his risk and financial responsibility, of the entrepreneur." [2].

The following table shows the classification of economic entities in numbers on the value of assets.

Private businesses can not be persons engaged in the following activity:

- Activities related to trafficking in narcotic drugs, psychotropic substances and precursors;
- Production and (or) the wholesale distribution of excisable goods;
- Activities related to the storage of grain on grain paragraphs;
- A lottery;
- Activities in the field of gambling and show business [3].

According to the "Agency of the Republic of Kazakhstan on Statistics," in Kazakhstan the number of registered SMEs in ten years increased 2.5 times, amounting to 837,083 units in 2011 against 323,731 units in 2002.

Table 1: Classification of business entities in the Republic of Kazakhstan.

	Type of ownership	Number of employees	The average annual value of the assets for the year (MCI for 2013 = 1731 tg.).	In U.S. dollars (Rates of the National Bank of Kazakhstan on 4.12.2013 1 \$ -154.25 tg)
Small business	Individual entrepreneur	Not more than 50 people	60 000 MCI (103 860 000 tg.)	Till 673 322 \$
Medium business	Legal entity	From 50-to 250 people	To 325 000 MCI (562575000)	Till 3 647 163 \$
Large enterprise	Legal entity	More than 250 people	More than 325 000 MCI	From 3 647 163 \$

Note: MCI is-monthly index established law on the national budget for the relevant financial year (author)

As for the volume of production, this indicator grew by 4.9 times accounting for 2,706.8 billion tenge in 2011 in comparison with 548.7 billion tenge in 2002. The number of employees in 2011 amounted to 1,737.7 billion people compared to 1,176.1 billion in 2002, increasing by 1.5 times.

Behind these figures, however, there is an indicator of unprofitability of SMEs in Kazakhstan. In the results of financial and economic activities, SMEs suffered 33.9% losses in 2011.

Calculations of the average number of employees and average volume of output of SMEs have been made on the basis of data from the Agency of the Republic of Kazakhstan on Statistics. On average, one SME employs 3 people. That one company manufactures products or produces services worth 6.5 million tenge. Thus, the elimination of just one SME causes the loss of 3 jobs and 6.5 million tenge in output or services [4].

According to experts, in Kazakhstan the main reason for the bankruptcy of companies in 80% of cases is poor adaptation to the changing conditions of the internal and external environment. In 20% of cases, the entrepreneur has a tax debt for the short term of activity of the company and often in these cases there is a question of the presence of suspicious transactions.

World experience proves that SMEs can easily adapt to crisis situations, are inclined to self-organization and self-development and with the proper public policy can provide fast social solutions. The role of risk in SME activity is very high and the need for risk management today is perceived as very high by most experts. Risk management in the activities of SME is an important element of management of the enterprise. SMEs, because of the narrow specialization of their activity, have the ability to respond quickly to changing market conditions. Studying specifics of the crisis phenomena of the Kazakhstan economy in recent years, we have identified and summarized the problems of SMEs and formulated a set of issues of SMEs in the sphere of trade, manufacturing and service.

Problems arising in connection with the necessity of borrowing for business development:

- Lack of microfinance institutions;
- High rate of interest on loans for small and medium enterprises;
- Revaluation of collateral;
- Deterioration of credit conditions;
- No awareness of SME representatives of government development programs;
- Not trusting attitude to aid provided by the state;
- Difficulties in working capital.

Problems with Contractors:

- A drop in demand for products or services;
- Strict requirements on the part of contractors;
- In the risk of non-payment by counterparties;
- Attempts to raiding by large contractors

Problems with the Participation in Public Tenders:

- Increased competition in public procurement;
- Failure to pay for work performed in prior periods;
- The lack of objectivity of the bidding process.

Problems associated with the expansion and modernization, innovation and application of:

- Lack of funds narazvitie;
- Not willingness of SMEs to risky situations;
- Does not resolve SMEs to large credit money;
- Freezing of development projects;
- The difficulty of obtaining certification for innovative products;
- Difficulty in attracting local investors
- The complexity and long -term planning.

Problems associated with personnel:

- An increase in utility tariffs;
- Reduction of capital turnover;
- Low qualification of specialists;
- Turnover;
- Lack of training centers for skills development.

Many SMEs suffered losses because they could not cope properly with the coming risks. Also, SMEs cannot effectively estimate the risks that threaten them. The choice of the method of risk analysis is limited due to the specifics of the activity of SMEs. Activity of SMEs precludes the possibility of using qualitative risk analysis based on analysis of available information. It is impossible because the primary information does not allow conclusions to be drawn about the real state of affairs, owing to the distortion of information in primary documents. Due to the lack of reliable information about the causes of risks, it is not possible to use the statistical methods.

That's why the most appropriate method of risk analysis for SMEs is the method of collecting new information, based on standardized questionnaires and consultations with experts, both working in the enterprise and externally.

Expert risk assessment methods are a set of logical and mathematical procedures directed toward receiving information and analyzing it in order to make rational decisions. "Expert assessment" is obtaining expert opinion on a particular issue by a special technique. The advantage of the analysis is that it can be carried out in a short term at relatively low cost. Methods of expert assessment are of two types:

- Teamwork of an expert group (brainstorming, business games, screenplays, meetings),
- Individual opinion of the expert (questionnaire, interview, Delphi method).

In our research we exclude collective work of an expert group as we have no possibility of utilizing this method. The suitable method for us is the individual expert opinion. The most convenient means of implementing this method is the use of questionnaires and interviews. The results obtained in the survey, which are not dependent on each other, must be combined in one generalized assessment of this or that risk and need to be calculated as an average value. During the survey, based on the opinions of experts, for each risk the corresponding sizes of possible losses and the probability of occurrence of the event are defined. Based on these estimates, we can determine the risk index.

$$R = P * I \quad (1.1)$$

Where P – is the average value of the probability of occurrence of a specific risk in points; I – is the average

value of losses of specific risk in points; R – risk index, is the measure of potential losses in points, which allows the impact of risk on the final results of the activities of SMEs to be judged [5].

The degree of risk-the size of probable losses, creating a negative effect on results of the activity of the SME. What kind of risk can be ignored or deemed insignificant depends on the appetite of the head of the company to risk.

But, critical or significant risks should not be a cause of failure of an activity. The head of an SME, as a result of risk management, can identify the priorities for the company. The staff of an SME is limited, so the head, puzzled with questions of how to counteract risks that arise, often faces a situation where it is difficult to designate a certain employee and authorize him/her exclusively to manage the risk. As a means of addressing this problem, we propose a mechanism to utilize management consulting. Thus, we suggest the involvement of an external consultant who is not included in the organizational structure of the company. This approach is advantageous as it leads to lower costs. The cost to the SME is reduced because it does not include a risk management consultant on its permanent staff. Specifics of SMEs usually do not allow them to hire consultants on a full time basis; therefore, a subcontract relationship allows minimizing these expenses.

An outside consulting organization gives recommendations to managers as to how to counteract risks. The management of the enterprise can follow these recommendations and also refuse them. Thus, responsibility for decision-making and its implementation lies with the management of the company.

An important task in risk management of SMEs, according to the methods available, is the allocation of risks. For the solution of this task, it is necessary to differentiate risks by allocating them into two groups:

- Risks, demanding involvement of consultants;
- Risks, not requiring involvement of consultants.

Risks of SMEs, requiring consultants, have the following characteristics:

- Damage from risk-average or considerable;
- The probability of occurrence -average or high;
- The emergence period – medium-term or long-term.

If the risk is estimated as being on the upper end of at least one of these zones, then the situation can be considered as requiring a consultant.

Table 2: Risk Classification by impact

Risk Index (R)	Risk	The impact
$20 \leq R \leq 25$	Critical	Extremely high level of impact on the bottom line of the entrepreneur
$15 \leq R \leq 20$	Significant	Reduce profits below an acceptable level, which has a significant negative influence on the final results of the company and questioned the achievement of the required result for companies
$10 \leq R \leq 15$	Moderate	Reducing the level of profit more than planned, but remains at an acceptable level, but a negative impact on the final results of the entrepreneur
$5 \leq R \leq 10$	Insignificant	Reduced total income within the planned and no significant impact on the final results of the entrepreneur
$1 \leq R \leq 5$	Ignorable	The absence of any impact on the bottom line of the entrepreneur

In analyzing whether to utilize an advisory mechanism to address risks, the governing body of the SME evaluates the entire spectrum of existing risks, considering each of them separately. After analyzing each risk in terms of potential damage, probability and time of occurrence, management can make one of two decisions-transfer the risk to a consultant or leave it within the functions of the administrative personnel of the firm.

As was already noted, the entire enterprise is not engaged in counteraction of risks, as the risk management function is usually not included in the daily task of the company's employees. Such tasks are in the competencies of the management of the firm. Due to the fact that SMEs do not usually possess a branched structure, tasks of risk management in most cases falls on the shoulders of the head of the company, though it is possible that he might delegate this function to one of his deputies.

As was stated above, part of the risks may be transferred to consultants and the other part remains in the management of SMEs. The list of risks includes:

- *Financial risks associated with contractual relations.* Violation of contractual relations is usually connected with elimination of contractors or change of their legal status. Strategic monitoring of the status of customers and suppliers as well as their financial condition can easily be accomplished by the heads of SMEs, since economic interaction is a part of their duties.
- *Risk management associated with the organization, supervision and staff.* Organizational risks and risks of personnel have a short-term character, so it is expedient to carry out counteraction to these risks without involvement of external consultants. In many cases, the time taken to transfer information to consultants and processing this information may exceed the time required to respond.

- *Political risks.* Probability of political risks associated with changes in the socio-economic system is not so great for SMEs and can be considered without involving external consultants.
- *Natural risks.* Natural risks related to weather and climate changes are easily predicted and are addressed by a business entity promptly.

CONCLUSION

Formation of an advisory mechanism can significantly improve the performance of SMEs; however, there still remains a serious problem of financing this mechanism. Considering the low profit of the SMEs, executives often refuse to create a system to counter risks; however such actions seem hardly justified.

SMEs possess smaller financial resources than large businesses; however, to involve third-party consultants is less expensive than to have experts in the regular fulltime staff of the company. In addition, the relatively small scale of economic activity in SMEs often doesn't require a full time workload for such an employee.

In comparison with use of the company's own staff, external consultation has one more important advantage for an SME- improvement of the quality of analysis that reduces the probability of emergence of mistakes and reduces the time for carrying out risk management activities. An external consulting organization, "supervising" multiple SMEs, is capable of developing standard decisions, based on synthesis of experience, that will allow lower expense and increased efficiency of actions to counteract risks.

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