

Relationship Between Structured Financial Planning and Firm's Growth: Study on the Small Companies in Bangladesh.

Md. Morshed Hasan Khan*

Md. Razib Alam**

Mamunur Rashid***

Quazi Sagota Samina****

***Abstract:** Structured financial plan is prerequisite to the survival of the firms, especially when the firms are growing from very small to large. Studies showed that 48% of the small companies totally failed and another 31% cannot operate smoothly due to wrong financial planning. This study has searched for existing methods of financial planning, techniques used, and accumulated recommendations based on practical experiences shared by financial managers of small firms in Bangladesh. A total of thirty two such firms were surveyed on different aspects of effective financial planning process with a vision to study the use of serious financial planning and its influence on the overall company growth. The study shows strong correlation between adoption to structured financial planning and growth of profitability. Use of technology, daily activity based planning, resource economics, reduction of owner's dominance, recruitment and training of effective human resources and setting up SME advisory policy with respect to effective corporate governance are the important suggestions by the managers to develop the financial planning system of their companies.*

***Keywords:** Serious Planning, Small Companies, Value Creation Process.*

1. INTRODUCTION

Financial planning plays perhaps the biggest role in constructing and developing a sustainable value creation process for any firm. It is the financial managers who decide

***Dr. Md. Morshed Hasan Khan**, Professor, Department of Marketing, University of Dhaka

****Md. Razib Alam**, Assistant Professor, Department of Marketing, University of Dhaka

*****Mamunur Rashid**, Senior Lecturer, Business Administration Department, East West University

******Quazi Sagota Samina**, Assistant Professor, Business Administration Department, East West University, Dhaka, Bangladesh.

the whistle to blow, machine to operate and the company to run. Their role deserves to be different in different cases, different for a small capital company than the giant multinationals, also different for a new entrant than “a hundred years young” company. Through this study on the small firms operating in Bangladesh, it is found out that unstructured financial planning is the premier reason behind the failure of majority of these companies. The study also shows that the procedure of construction and implementation of financial planning tend to be desecrated far away than which is followed by the leading companies of this level in Bangladesh. Use of technology and reduction of owners dominance were the effective suggestions. It was a comparative study among the small enterprises about how they are preparing and responding towards the financial planning and what should be the fruitful ending to this process?

By definition, Planning is the process through which interrelated objectives are set to accomplish desired goals for short and long run benefit of the firm. Planning is the most sensitive, time consuming and costly stage of corporate decision making. One other hand, Financial Planning can be either ‘Serious,’ which is a combination of modern tools and techniques and experience of the managerial team or it could be ‘Naïve’ with no modern techniques and mostly dependent on the average growth model and arbitrary targeting policy. A serious planning will enable the small firms to congregate proper, timely and low cost fund and profitable investment of that fund in best alternative possible. Theoretical understanding of financial planning from the past researches is explained in the second chapter. The third chapter gives the details of the data and methodologies. The fourth chapter reports the results of the study and the last chapter, chapter five, concludes with potential changes in the financial planning for future.

2. SMALL COMPANIES AND FINANCIAL PLANNING: LITERATURE REVIEW

Numerous definitions of small companies can be given. The definitions are different for different countries with different economic situations. This study has taken the definition given by Daniels (2003) and Ahmed (2001) in two researches done on the SME of Bangladesh. Both the authors in their researches used the capital base and number employees to identify the small companies. A company will be called small company if it has less than fifty employees currently working and has a present capital of less than a 100 Million Taka (Daniels, 2003; Ahmed, 2001).

Attitude of the financial managers, from the survey regarding financial management, was found to be monotonous and by financial management they mean (1) to pressurize the sales department to capitalize on less number sales people for better month-end return, (2) to be ready with month-end income and expense report to show it to the owner-

manager (3) to balance the assets and liabilities of the firm at the end of the year by an auditor for the sake of paying taxes and lastly (4) to be ready for salary payment date to come. In some points of time, the gigantic dominance of the owners on the planning process violates the usual norms of coordination, which is, in most of the cases, not healthy for growth orientation.

Premier objective of financial planning is to design financial activities such a way that searches for profitable means of doing business for the firms keeping in mind that the organization is going concern with its long-term vision and about its physical capacity to generate success to the development and growth. Financial problem has found to be the biggest constraints for the small firms to be started, established and grown up (World Bank, 2004). The occurrence of such failure due to financial problems could be sourced from many different holes i.e. *lack of credit service* (financing facility to start business) to the small firms (Data International, 1999), *lack of profitability*, *customers not paying credit* etc. (Daniels, 2003) . For 10.7% firms, *default in marketing techniques* and for 1.4% firms, it is the *inept management system* that make the company a failure (Data International, 1999).

Daniels (2003) found that due to *lack in financial planning and forecasting* and *lack of financial infrastructural facilities*, 48% of small firm face problem to start a business and after starting another 31% firms cannot be operated smoothly. So, these firms absolutely having problem with sourcing their funds and utilizing scares fund in opportunities with quickest cycle of investment return.

Structured Financial Planning not only supports success rate (Jones, 1982) but also affect the level of performance (Schwenk and Shrader, 1993). Studies found **planning sophistication** brings financial betterment to small companies (Rue and Ibrahim, 1998). Research shows that a consistent relationship between structured planning and company growth and performance in small business (Robinson and Pearce, 1984). Berrgman (1983) and Peacock (1985) found **careless or less serious financial planning** as the most important reason behind the failure of most small companies. Robinson and Pearce (1984) authored a comprehensive review of literature on the impact of strategic planning and small company performance. The report says that knowledge about strategic financial planning is inadequate with the small companies and therefore, the impact is negative compared to large firm.

A meta-analysis done by Shrader and Schwenk (1993) of twenty four small companies found out that **sales planning along with sales forecasting** and **cost benefit analysis** shows a positive impact on the growth of profitability in the USA, and most of company starts their financial planning with a rigorous sales forecasting methodology.

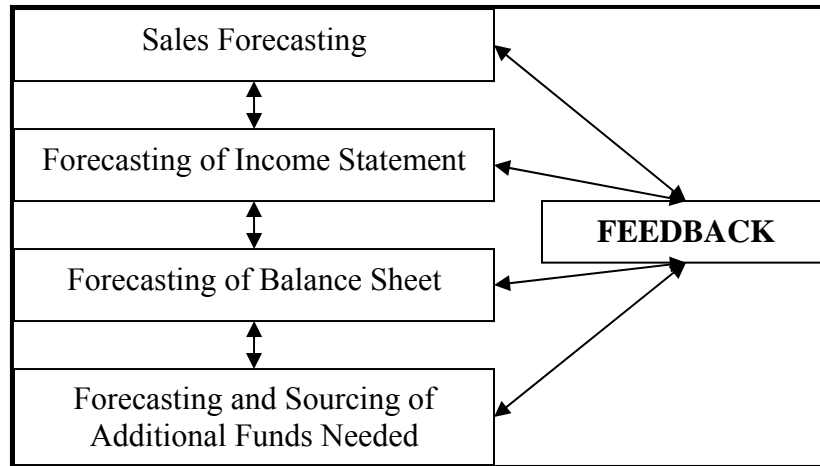
Kuratco (1991) found the importance of **time based planning** in small company financial management and the result shows most of the failed small companies are **short-term decision makers**. **Daily activity based planning** in respect to summary result and feedback has been found with profitable small companies (DeThomas and Fredenburgh, 1985). Daily activities include working capital management, inventory management, credit management etc. This study recommends that these small activities will ultimately form a collective affect on income statement and balance sheet management.

Holmes and McMahon (1991) report positive relationship between **technology and statistical techniques** used in financial planning with better small company performance. Further studies undertaken by Cheney (1993), Raymond (1985), Malone (1985), DeThomas and Fredenberger (1985), Farhoomand and Hyck (1985), Nichols and Seado (1986), Raymond and Megnenat-Thalman (1982) reported the importance and implications of computer with upgraded software among the small companies in the USA.

Luoma (1967) found negative relationship between **owners being the manager** and use of financial information. Eighty six percent of sixty two small and medium manufacturing companies surveyed by Luoma (1967) showed that preparation and interpretation of **pro-forma financial statement** is mainly manager decided.

Though studies done by D'Amboise and Gasse (1980) found small manufacturing doing **in-depth analysis**, however Lindecamp and Rice (1983) evidenced completely opposite result. In the later studies on 173 owner-managers, it was found out that small retail stores are not acquainted with detailed analysis. Detailed analysis shows an overall integration of all financial activities using modern software. However, in DeThomas and Fredenberger (1985) survey, 61% of the small companies think that pro-forma financial statement must be a part of formal analysis.

So, a conceptual financial planning model should include sales forecasting, pro-forma financial statement, sourcing the additional fund needed and supported by an overall feedback mechanism. Marakon Associates and Economic Intelligence Unit jointly introduced the Continuous Model of Financial Planning (Harvard Business Review, 2006). Bank of England also established a model for structured financial planning of the small companies. Besley and Brigham (2005) pointed the right model by considering all the components discussed above. Diagram 01 briefs the model:

Diagram 01: Conceptual Structured Financial Planning Model

Source: Besley and Brigham (2005).

3. DATA AND METHODOLOGY

The study finds out the relationship between structured financial planning and performance of small and medium enterprises. Data were primarily collected by using structured questionnaire (please refer to Table 01 in Appendix) from fifty companies, those are headquartered in Dhaka, at the most convenient basis. As explained by Daniels (2003) and Ahmed (2001), SME were selected on the basis of number of current employees (less than 50) and capital as on year 2006 of less than 100 Million Taka. Due to missing data, thirty two companies (success rate is 64%) are selected at last for analysis. Secondary data were collected from periodicals, professional magazines, published articles and electronic sources to get ideas on past researches and actual practice to form an optimal model of financial planning, on which the data will be collected. SPSS Computer Package was used to analyze data.

Due to regulatory hazards, companies were reluctant to give quantitative data. Data were collected in three different categories: 1). Demography of the company and respondents, 2). actual practice of the companies (Dichotomous results - Yes and No) and 3). Decision variables from the respondents regarding what to be done to make financial planning better (Likert 5 Scale). A total of 24 variables have been considered for data collection in the above listed three different categories.

3.1 Variables:

First demographic variable is the AGE OF THE COMPANY, where '1' represents less than one year, '2' is for two to five years and '3' is used for companies operating for more than five years. TYPE OF BUSINESS is the second variable, where '1' represents that the company is a sales and distribution company, '2' is for manufacturing and '3' is for other types of companies. Next variable is the EXPERIENCE OF THE RESPONDENTS. In this case '1' will represent that the respondent is working in the same position for less than one year, '2' is used for two to five years category and '3' is used to experience level of more than five years. The fourth variable is the DESIGNATION OF THE RESPONDENTS, where '1' represents that the respondent is a financial manager and '2' shows that he or she is a officer in finance or accounts department. We have collected data on average historical GROWTH OF PROFIT of the selected companies and here '1' represents the companies with negative average profit growth, '2' represents the companies with average one to five percent of historical growth of profit and '3' represents the companies with more than five percent of profit growth. The last variable in demographic criteria is whether the manager is an owner (OWNER-MANAGER). '1' means the owner is not the manager and '2' means the owner is the manger.

Second type of variables are on ACTUAL PRACTICE. Here the answers are collected either in '1' if the companies are not practicing specific activities or in '2' if they think they are currently practicing it. The variables will answer the questions, whether the companies have fully adopted to financial planning or not, is sales forecasting arbitrary, whether technology is used in sales forecasting, whether owners puss dominant pressure on sales forecasting, are sales targets timely communicated to the sales persons, are companies used to with forecasting of financial statement, is sales growth method used in sales forecasting, has the bank been used as the primary source of additional capital or there are any other sources and lastly, whether the managers deal with the bank or not?

The third kind of variables are DECISION VARIABLES, where data were collected on the basis of Likert Five Point Scale ('1' represents that the respondents strongly disagree about the impact of this variable on success of financial planning and '5' shows that they are strongly agree that the variable has strong impact on the success of financial planning) and then these are categorized on the basis for growth of profit to show the difference between different types of companies. The variables are daily activity based planning, resource economics, dominance of the owners, participation of the owners, establishing SME advisory council, patronization by the government, using sales planning (strategically) rather than mare sales forecasting, use of technology in financial forecasting, and whether financial planning will increase employee participation or not.

Table 02: Descriptive Statistics of Sample

	Age of the Company	Type of Company	Experience of the respondents	Designation of respondents	Owners are Managers
N	32	32	32	32	32
Missing	0	0	0	0	0
Mean	2.16	1.84	2.81	1.13	1.53
Std. Dev	0.847	0.808	0.397	0.336	0.507

Table 03: Respondent Profile according to Age of the Company

	Freq.	%	Cum %
Less Than One Year	9	28.1	28.1
Two to Five Years	9	28.1	56.3
More than Five Years	14	43.8	100.0
Total	32	100.0	

Table 04: Respondent Profile according to Type of Company

	Freq.	%	Cum %
Sales & Distribution Companies	13	40.6	40.6
Manufacturing Companies	11	34.4	75.0
Others	8	25.0	100.0
Total	32	100.0	

Table 05: Respondent Profile on whether the Owners are Managers or not.

Answer	Freq.	%	Cum %
No	15	46.9	46.9
Yes	17	53.1	100.0
Total	32	100.0	

Table 06: Experience of the respondents

	Freq.	%	Cum %
Two to Five Years	6	18.8	18.8
More than Five Years	26	81.3	100.0
Total	32	100.0	

Table 07: Designation of the respondents

	Freq.	%	Cum %
Financial Manager	28	87.5	87.5
Officer	4	12.5	100.0
Total	32	100.0	

3.2 Respondent Profile

Out of a total of 32 companies, 28.1% of the companies have been operating for less than one year, another 28.1% for one to five years and 43.8% companies were working for more than five years (Table 03). On an average, companies were mostly from more than five years category (Mean is 2.16 where 2 is the point used for one to five years category)

(Table 02). 40.6% of the sample were engaged with sales and distribution business, 34.4% were in small scale manufacturing business and 25% were engaged with other, mostly service oriented, businesses (Table 04). More than fifty percent of the companies were managed and ran by the owner-manager and with in the rest (46.51), managers are responsible for most of the think skinned decisions (Table 05). The survey has been conducted mostly on the finance and or accounting department of the small companies. Respondents were, in most of the cases (87.5%), financial managers (either the owners themselves or the managers) and the rest of the respondents are officers under the financial managers (Table 07). Reliability of theses responses (12.5%) made by the officers has been ensured by cross checking the answers with the managers for most of the questions. But the actual survey was done on the officers. 81.3% of these respondents have been working for more than five years and the rest 18.8% have been working for two to five years in the same positions (Table 06).

3.3 Methodology

To accomplish our objective, the study uses four different types of statistical techniques. To show the relationship between variables, correlation coefficient, Chi-Square Test have been used. Frequency Distribution and Cross-Tabulations have been shown to represent the significance impact and influence among different variables. At last, ANOVA has been done to show the difference between different types of companies, according to their growth in profit (i.e. negative, one to five percent and more than five percent growth), for different decision variables.

4. HYPOTHESES, RESULTS AND DISCUSSIONS

4.1 Hypotheses for Relationship among variables

The following hypotheses have been tested for relationship. Pearson product moment correlation and chi-square test results have been shown in the following table.

$H_0 =$ Variables are not correlated.

$H_1 =$ Variables are correlated.

Table 08: Testing Relationship between variables.

SL	Hypotheses	P Value ($\alpha = 0.05$)	Accepted
1	A. Full adoption to financial planning and B. Growth of profitability.	0.000 (0.803)	H ₁
2	A. Arbitrary sales forecasting and B. Growth of profit.	0.000 (-0.106)	H ₁
3	A. Use of statistical techniques in sales forecasting and B. Growth of profit.	0.000 (0.840)	H ₁
4	A. Owners' dominance on sales forecasting and B. Growth of profit.	0.000 (-0.722)	H ₁
5	A. Formal communication of sales target to sales people B. growth of profit.	0.000 (0.726)	H ₁
6	A. Preparation of pro-forma financial statements and B. Growth of profit.	0.000 (0.723)	H ₁
7	A. Sales growth method to forecast financial statements B. Growth of profit.	0.000 (0.878)	H ₁
8	A. Collection of additional fund from bank and B. Growth of profit.	0.571 (0.104)	H ₀
9	A. Owners being the managers and B. Growth of profit.	0.000 (-0.840)	H ₁
10	A. Age of the company and B. Full adoption to financial planning.	0.668* (0.079)	H ₀

Figures in parenthesis are the correlation coefficient.

Figures with *show test result of Chi-Square.

4.2 Hypotheses for Difference between group of companies according to their growth of profit for Decision Variables.

$$H_0^2 = \mu_1 = \mu_2 = \mu_3$$

$$H_1^2 = \mu_1 \neq \mu_2 \neq \mu_3$$

μ_1 =Average of Companies with Negative Growth of Profit.

μ_2 =Average of Companies with '0 - 5%' Growth of Profit .

μ_3 =Average of Companies with More than 5% Growth of Profit.

Table 09: ANOVA for Differences in Decision Variables for the Groups of Companies

SL	Decision Factors	Mean Response (on Growth of Profit)			P Value	Accepted $\alpha = .05$
		(-) ve Profit	0 to 5%	> 5%		
1	Daily Activity Based Planning	1.75	3.45	4.92	0.000	H1
2	Resources Economics should be understood	4.5	4.83	4.85	0.000	H1
3	Owner's dominance should be reduced	2.13	3.91	4.92	0.000	H1
4	Banker's Participation is greatly expected	3.75	4.61	4.52	0.051	Ho
5	SME Advisory Council might be of good help	4.38	4.73	4.23	0.354	Ho
6	Govt. Patronization is required	3.75	4.55	4.92	0.000	H1
7	Sales Planning rather Sales Forecasting should be made	2.5	3.82	4.92	0.000	H1
8	Technology will make financial planning better	3.25	3.55	4.77	0.004	H1
9	Financial Planning will increase employee participation	3.13	3.64	4.85	0.003	H1

Source: Compiled from SPSS.

4.3 Discussions

Details of actual practice are discussed below:

(1) Full adoption to financial planning and profitability are strongly positively correlated, therefore, small companies should start practicing the model to increase value of the company.

(2) Arbitrary sales forecasting leads to decline in profitability of the companies. Table 10 shows that 53.1% of the companies use arbitrary sales forecasting, which is not serious financial planning.

(3) The companies using statistical techniques are achieving maximum profit compared to their competitors. 43.75% The rest used different techniques to forecast sales; specially the linear growth method, moving average and time series analysis (Table 11).

(4) Low dominance from the owner on sales forecasting will increase the profitability of the company. Table 12 shows that sales targets, forecasting and sales force management in one third companies were dominated by the owners.

(5) 30% of the company sales people do not get the actual sales target formally and timely (Table 13) and result shows formal communication of sales targets to the sales people is strongly correlated to growth in profit. In most of the cases, these companies do not call any sales meeting.

(6) Estimating the financial statements and setting objectives before time strongly helped 60% of the companies increasing their profit (Table 14). Lack of efficient human resources restrain the rest 40% to gain that benefit.

(7) Using sales growth method in forecasting pro-forma financial statements will increase the profitability.

(8) Funding extra money from bank is not related to growth of profit. Though 78.1% of the companies rely on bank (Table 15), the relationship between bank financing and profitability is not statistically significant.

(9) Manager controlled companies defeated owner controlled companies in terms of earning profit.

(10) Age of the companies are unrelated to full adoption to financial planning. In fact, adopting to new financial planning depends on the leadership rather than the time.

(11) The lowest mean carrying factors with the highly profitable companies are (1) bankers participation in the financial planning process (Mean = 4.52) and (2) introduction of SME advisory council (Mean = 4.23) respectively. These two points, in fact, caught the most of the attention since the companies were not supporting outsiders to handle their company matter, and especially very sensitive matter like financial management. All other decision factors have been rated as tremendously important the successful managers.

5. CONCLUDING REMARKS

Small companies are the heart of any economic developments. Average 20-25% of GDP in Bangladesh has been contributed by SMEs' (Daniels, 2003). 80-85% of the industrial employment and 23% of the total civilian employment have been contributed by SMEs' (SEDF, 2003). But the survival of these companies depend on serious financial planning. Moreover, competition from both home and abroad is creating serious trouble for the small companies. The results show that one type of firms use a combination of different tools and techniques and managerial experience to plan for the sales; forecast the sales, income statement, balance sheet, additional fund needed for financing the estimated growth. Combining a serious managerial team spirit, firms judge the feedback of the process and make an adjustment with the next financial plan. Another type of firms is taking the average of the growth made in the last years and fixing an arbitrary target for the next year. Due to several problems, financial managers are left with very limited choices. Therefore, they should be concentrating on the following issues to accumulate their importance in the economy:

- (1) Efficient human resources should be recruited and developed to proactively plan for strategic challenges.
- (2) Daily activity planning system can be used by using different technology driven methods. These will help in automatic detection of problem ahead of occurring.
- (3) Companies should organize time sales meeting, if not centrally at least regionally, so that sales targets and sales related planning can be done and monitored carefully.
- (4) Owners' dominance should be reduced from every aspect of operational decision making. Managers should be given adequate flexibility to handle the decisions.
- (5) Better relationship with banks might provides with easy source of collecting additional funds needed at less cost possible, since it is very difficult to collect instant financing for the small companies. But owners should monitor the relationship between bankers and the managers about any financial deal.

(6) Government should produce prudential small company corporate governance guidelines and monitor its implication for SME governance. Also, it should patronize the development SMEs' by expanding the horizon of investment.

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7. APPENDICES

Questionnaire used for Data Collection

Table 01: Details of Variables.		
SL	Variable	Description
Demographic Variables		
1	Age of the Company	Years of operation of the company. 1 = Less than one year. 2 = Two years to Five years. 3 = More than Five years.
2	Type of Business	Type of company operation. 1 = Sales and Distribution Companies. 2 = Manufacturing Companies. 3 = Others
3	Respondent experience	Years of experience of respondents. 1 = Less than one year. 2 = Two years to Five years. 3 = More than Five years.
4	Respondents Designation	Official designation of the respondents. 1 = Financial Managers. 2 = Officers.
5	Growth of Profit of the sample	Historical average growth of profit for last two years. 1 = Negative 2 = Less than 5% 3 = More than 5%
6	Owners are managers	Whether the owners are managers in this companies. 1 = No 2 = Yes
Actual Practice [1 = No, 2 = YES]		
7	Full adoption to financial process	No = Companies did not adopt financial planning fully. Yes = Companies adopted financial planning fully or

		at least in the process of adoption.
8	Sales forecasting is arbitrary	No = Sales have not been forecasted arbitrarily. Yes = Sales have been forecasted arbitrarily without using any scientific models.
9	Technology is used in sales forecasting	No = Technology in any form was not used in sales forecasting. Yes = Technology was used in sales forecasting.
10	Owners have dominant power over sales forecasting	No = Owners do not dominate the sales forecasting. Yes = Owners dominate the sales forecasting.
11	Sales targets are communicated to sales force.	No = Sales target is not timely and formally communicated to sales force. Yes = Sales target is timely and formally communicated to sales force.
12	Preparation of Pro-forma financial statement	No = Companies do not Forecast Financial Statement. Yes = Companies Forecast Financial Statement.
13	Use of sales growth in sales forecasting	No = Sales Growth Method was not used for Forecasting Financial Statements. Yes = Sales Growth Method was used in Forecasting Financial Statements.
14	Bank is the primary source in funding the additional capital	No = Additional Fund Needed was not collected from Bank (may be a combination of debt and equity) Yes = Additional Fund Needed was fully collected from Bank.
15	Manager is used to deal with the bank	No = Managers don't deal with the banks (may be the owners or a combination was handling bank activities). Yes = Managers deal with the banks.
Decision Variables [1 = Strongly Disagree 5 =Strongly Agree]		

16	Daily Activity Based Planning.	Daily Activity Based planning will help in serious financial planning.
17	Resource Economics.	Effective Resource Economics should be used.
18	Owners Dominance.	Owners dominance should be reduced from the financial planning process.
19	Bankers Participation.	Bankers participation should be increased.
20	SME advisory council.	SME Advisory Council should be introduced to assist in effective financial planning.
21	Govt. Patronization.	Government should patronize the practice of structured financial planning through prudential regulations.
22	Sales planning vs. sales forecasting.	Sales planning rather than sales forecasting should be practiced.
23	Technology in financial planning.	Use of technology will help in structured financial planning.
24	Financial Planning and employee participation.	Structured Financial Planning will increase the employee participation.

Table 10: Sales Forecast is Done Arbitrarily

	Frequency	Percent	Cumulative Percent
No	17	53.1	53.1
Yes	15	46.9	100.0
Total	32	100.0	

Table 11: Statistical Tools is Used in Sales Forecasting

	Frequency	Percent	Cumulative Percent
No	18	56.25	56.25
Yes	14	43.75	100.0
Total	32	100.0	

Table 12: Owner's Impact on Sales Forecasting

	Frequency	Percent	Cumulative Percent
No	21	65.6	65.6
Yes	11	34.4	100.0
Total	32	100.0	

Table 13: Timely Communication of Sales Target to Sales People

	Frequency	Percent	Cumulative Percent
No	10	31.3	31.3
Yes	22	68.8	100.0
Total	32	100.0	

Table 14: Company Prepares Pro-forma Income and Balance Sheet

	Frequency	Percent	Cumulative Percent
No	13	40.6	40.6
Yes	19	59.4	100.0
Total	32	100.0	

**Table 15: Additional Fund Needed is mostly collected from Bank
(otherwise owners provide it)**

	Frequency	Percent	Cumulative Percent
No	7	21.9	21.9
Yes	25	78.1	100.0
Total	32	100.0	

91	92	93	94	95	96	97	98	99	100	101
102	103	104	105	106	107	108	109	110	111	112
113	114	115	116	117	118	119	120	121	122	123
124	125	126	127	128	129	130	131	132	133	134
135	136	137	138	139	140	141	142	143	144	145
146	147	148	149	150	151	152	153	154	155	156
157	158	159	160	161	162	163	164	165	166	167
168	169	170	171	172	173	174	175	176	177	178
179	180	181	182	183	184	185	186	187	188	189
190	191	192	193	194	195	196	197	198	198	199
200	201	202	203	204	205	206	207	208	209	210
211	212	213	214	215	216	217	218	219	220	221
222	223	224	225	226	227	228	229	230	231	232
233	234	235	236	237	238	239	240	241	242	243
244	245	246	247	248	249	250	251	252	253	254