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## The Relationship between Tax-Related Administrative Barriers and SMEs Characteristics: Evidence from Slovenia

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**Abstract:**

**Purpose:** Legislation and tax authority conduct upon play a very important role in determining overall business environment by defining the rules under which the enterprises have to operate. Nonetheless, the complexity of legislation creates also unnecessary administrative burdens and consequently hinders entrepreneurial activity. Accordingly, the main aim of this paper is to establish whether there is a link between the perception of administrative barriers in the field of tax compliance and financial reporting and different characteristics of small and medium enterprises (SMEs).

**Design/Methodology/Approach:** Conducting a field survey and applying a parametric statistical technique on a sample of 293 Slovenian SMEs.

**Findings:** The empirical results show that there are statistically significant differences in characteristics between those SMEs that perceive administrative barriers above average and those that perceive administrative below average in the field of tax compliance and financial reporting.

**Practical Implications:** The overall findings suggest that regulatory authorities bear in mind that complexity of tax-related administrative barriers have a price resulting in deterioration of the business environment for SMEs and their performance.

**Originality/value:** Utilising a comprehensive dataset covering Slovenian SMEs made by merging multiple data sources, namely field survey, balance-sheet and income-statement data, representing the main originality and value of the paper.

**Keywords:** Administrative barriers, tax compliance, financial and accounting reporting, SMEs, Slovenia.

**JEL Codes:** K23, L26, H83.

**Paper type:** Research study.

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## **1. Introduction**

Small and medium-sized enterprises (SMEs) are very important, especially in small economies, such as Slovenia, as they represent the engine of growth and job creation. In Slovenia, SMEs represent almost the whole population of enterprises providing over 72% of employment and nearly 63% of value added (European Commission, 2017). However, compared to large enterprises, SMEs often have worse performance, which is reflected in lower profitability, higher staff turnover, lower rate of survival etc. (European Parliament, 2016). All three of these presumably result from the obstacles SMEs typically encounter across Europe and Slovenia. In the economic literature, there are various barriers highlighted that SMEs are facing, whereby administrative barriers and their removal are of great importance, especially in terms of improving the business environment and achieving greater competitiveness of the economy.

Generally, administrative barrier represents everything that unjustifiably hampers business operations of enterprises. It covers all costs arising from unnecessary administrative obligations that enterprises must fulfil due to the legislation. Administrative barrier represents an administrative burden, which is not strictly necessary for the achievement of the public interest, not rationally justified and can be removed without any damage to the public interest (Ministry of the Interior, 2013). Enterprises can face these barriers in different fields, whereby the field of tax compliance and financial (and accounting) reporting are of great importance. According to Doing Business report issued by the World Bank, Slovenia is still behind some other EU member states (e.g. Ireland, Denmark, United Kingdom) in paying taxes (World Bank, 2017). This implies that there is still a lot of potential room for improvement in terms of reducing and removing administrative barriers in this field. Moreover, the importance of this field is further reinforced by the fact that every single enterprise is obliged to pay public duties and to submit financial and accounting reports.

Accordingly, the main aim of this paper is to establish whether there is a link between the perception of administrative barriers in the field of tax compliance and financial reporting and different characteristics of SMEs. In other words, this paper aims to establish whether there are differences in the characteristics of SMEs between those that perceive administrative barriers to a lesser extent (below average) and those that perceive administrative barriers to a greater extent (above average). The remaining sections of this paper are organized as follows. In the next section, a literature review is presented. The following section describes the data and research methods. In the next section, the empirical results are presented. The paper ends with conclusion in which the main findings are summarized.

## 2. Literature Review

Clear, transparent and unambiguous legislation represents a prerequisite for a friendly business environment in which enterprises operate. Scientific literature notes that economies with better legislation and regulations grow faster (Djankov, McLiesh and Ramalho, 2006). Most of the EU member countries are therefore seeking to reduce bureaucracy, as this can lead to a better business environment for SMEs (Aristovnik and Obadić, 2015). However, the extensive legal regulation adopted in recent years in the EU member countries and lengthy administrative are becoming increasingly burdensome for enterprises. It is well established in the literature that administrative barriers stemming from existing legislation and regulations hinder the performance, productivity and growth of the private sector, which relates mainly to SMEs (Bartlett and Bukvić, 2011; Břečková and Havlíček, 2013; Dubrova *et al.*, 2019; Grima *et al.*, 2019; Hanfan *et al.*, 2018; Havlíček *et al.*, 2013; Milavec and Klun, 2011; Setyawati *et al.*, 2019; Slabe-Erker and Klun, 2012).

In the field of tax compliance and financial reporting, there are also many administrative barriers (Pavlák, 2018; Ravšelj and Aristovnik, 2018; Ravšelj *et al.*, 2019; Ropret *et al.*, 2018). Generally, tax compliance is defined as the willingness of individuals and other taxpayers to act in accordance with tax legislation without the use of coercive measures (James and Alley, 2002). The fulfilment of these obligations thus includes the true reporting of the tax base, correct computation of tax liabilities, timely filling of tax returns and timely payment of the amount due as tax (Chaltopadhyay and Das-Gupta, 2002; Franzoni, 2000; Rupeika-Apoga and Solovjova, 2017; Rupeika-Apoga and Saksonova, 2018). This also requires the proper financial record keeping. Due to the extent, instability and inconsistency of existing legislation in the field of tax compliance and financial reporting, SMEs that perceive those administrative barriers to a greater extent may have worse operating performance, business efficiency and solvency. Therefore, the following hypotheses are proposed:

***Hypothesis 1:*** *SMEs that perceive administrative barriers to a greater extent in the field of tax compliance and financial reporting have worse operating performance.*

***Hypothesis 2:*** *SMEs that perceive administrative barriers to a greater extent in the field of tax compliance and financial reporting have worse business efficiency.*

***Hypothesis 3:*** *SMEs that perceive administrative barriers to a greater extent in the field of tax compliance and financial reporting have worse solvency.*

In addition, also other characteristics of SMEs may also vary in terms of perceived administrative barriers in the field of tax compliance and financial reporting. Namely, every single enterprise is engaged in different activities stemming from taxation and financial reports on a daily basis. This can hamper business operations especially of younger and smaller SMEs. Namely younger SMEs, which are

generally in the initial stage of development and looking for their opportunity in business, are often confronted with a lack of the knowledge of tax regulation and accounting standards as well as infrastructure to implement existing tax and accounting rules (UNCTAD, 2000). Therefore, the following hypotheses are proposed:

***Hypothesis 4:*** *SMEs that perceive administrative barriers to a greater extent in the field of tax compliance and financial reporting are younger.*

***Hypothesis 5:*** *SMEs that perceive administrative barriers to a greater extent in the field of tax compliance and financial reporting are smaller taxpayers.*

### **3. Data and Research Methods**

The unique database for empirical analysis was made by combining field survey data and data from the financial statements (balance sheet and income statement) of SMEs. Database building was therefore carried out in two consecutive steps. The first step refers to the collecting data with a questionnaire. The content of questionnaire was formed by the academia experts in the economic and legal fields together with the recommendations from the practitioners, i.e. representatives of the Chamber of Craft and Small Business of Slovenia as well as entrepreneurs. It contains 39 questions, of which one is of an open type and covers different key fields, where SMEs can face administrative barriers. The respondents could leave certain questions blank if the content was not applicable to them. The questionnaire was distributed via field survey, which has been running for three months until April 2017. The field survey resulted in 652 responses. This data was merged with data from the financial statements of SMEs, which was provided by the Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES, 2017).

The sample for the analysis is reduced for those SMEs, which either cooperate only with one business partner from the beginning of SMEs foundation or did not respond to this question, since these are so-called fictitious enterprises. Moreover, the sample is reduced for those SMEs, which gave conflicting answers in the questionnaire (on the one hand, some SMEs responded that they do not use any outsourcing (accounting services) while on the other they responded that they need less than 1 hour per week to meet the obligations of the public administration without outsourcing). For the purposes of the empirical analysis in this paper, SMEs are divided by considering their perception of administrative barriers in the field of tax compliance and financial reporting. From the sample are excluded those SMEs, which perceive administrative barriers to a medium extent. In other words, in the analysis are included only those SMEs that perceive administrative barriers in the field of tax compliance and financial reporting to a lesser extent (below average) and those that perceive administrative barriers to a greater extent (above average). Therefore, the final sample of SMEs, which is used in the analysis, includes 293 Slovenian SMEs. In the empirical analysis, the following variables are used:

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- *Fixed assets turnover ratio – operating performance* (measured as coefficient) is the ratio of sales (on the profit and loss account) to the value of fixed assets (on the balance sheet). It indicates how well the enterprise is using its fixed assets to generate sales. A higher value of this ratio indicates that an enterprise has more effectively utilized investment in fixed assets to generate revenue.
  - *Operating revenues to operating expenses – business efficiency* (measured as coefficient) is the ratio between revenues generated and operating expenses incurred. It reflects the performance of the enterprise. A higher value of this indicator means better business efficiency of the enterprise.
  - *Payables deferral period - solvency* (measured in days) is calculated as accounts payable divided by costs of goods sold over 365. It represents the average length of time between the purchases of supplies, materials, and labour and the payment of cash for them. A lower value of this indicator means that the enterprise pays its payables in a shorter time.
  - *Existence of SME – SMEs age* (measured on a five-level scale: (1) less than 1 year, (2) 1-5 years, (3) 6-10 years, (4) 11-20 years, (5) more than 20 years). It reflects the enterprise's age.
  - *Tax on profit on ordinary operating activities – size of a taxpayer* (measured in EUR) is the amount of tax, which the enterprise has to pay out of the taxable profit. It reflects the size of a taxpayer.

In order to test the all of the proposed hypotheses, an independent-samples t-test is performed. This parametric statistical technique is considered to be very robust method and it is the most commonly used method for detecting differences in averages between two groups (Rasch, Teuscher and Guiard, 2007). Therefore, all the results are presented in the form of average values of responses.

#### **4. Empirical Results**

The aim of the empirical analysis is to establish whether there are differences in characteristics of SMEs between those that perceive administrative barriers to a lesser extent (AB below average) and those that perceive administrative barriers to a greater extent (AB above average). The results of t-test are presented in Table 1.

The results of t-test show that there are statistically significant differences between those SMEs that perceive administrative barriers to a lesser extent and those that perceive administrative barriers to a greater extent in the field of tax compliance and financial reporting. Comparison between these two groups of SMEs reveals that those, which perceive administrative barriers above average, have worse operating

performance (27.52 compared to 59.18), worse business efficiency (1.03 compared to 1.10) and worse solvency (113.94 compared to 69.77) than those, which perceive administrative barriers below average.

Moreover, the results also reveal that SMEs which perceive administrative barriers above average are younger (3.39 compared to 3.71) and pay lower tax on profit (4,395.00 compared to 12,785.29) than those, which perceive administrative barriers below average.

**Table 1.** Results of t-test regarding the relationship between tax related administrative barriers and SMEs characteristics

Variable	Group of SMEs	N	Average	P-value
Operating performance	AB below average	150	59.18	0.018*
	AB above average	73	27.52	
Business efficiency	AB below average	180	1.10	0.025*
	AB above average	88	1.03	
Solvency	AB below average	180	69.77	0.036*
	AB above average	88	113.94	
Enterprise's age	AB below average	195	3.71	0.040*
	AB above average	98	3.39	
Size of a taxpayer	AB below average	103	12,785.29	0.048*
	AB above average	55	4,395.00	

**Note:** \* indicates statistical significance; sample size may differ depending on the individual variable.

**Source:** Questionnaire survey, 2017; AJPES, 2017; own calculations.

Based on the empirical results, all of the proposed hypotheses are confirmed. All of the aforementioned findings are in line with the findings of other authors, who analysed the relationship between administrative barriers and SME performance (Bartlett and Bukvić, 2011; Milavec and Klun, 2011; Slabe-Erker and Klun, 2012).

## 5. Conclusion

Almost the entire Slovenian economy consists of SMEs and therefore play an important role in economic growth and job creation. In general, it is known that SMEs often have worse performance than large enterprises, which is reflected in lower profitability, higher staff turnover, lower rate of survival etc. SMEs are therefore more exposed to administrative barriers in the field of tax compliance and financial reporting, which usually hinder business operations. Namely, the costs related to tax compliance and financial reporting do not change much with the size of enterprise and consequently can be considered as fixed costs. The mentioned fixed-cost nature of tax regulation and simultaneous lower efficiency of smaller enterprises in dealing with legislation cause disproportion of tax-related administrative barriers. This usually represents the most frequent reason, why tax legislation can be challenging for SMEs.

The empirical results of this paper show that there are statistically significant differences in characteristics between those SMEs that perceive administrative barriers above average and those that perceive administrative below average in the field of tax compliance and financial reporting. They reveal that SMEs, which perceive administrative barriers to a greater extent, have worse operating performance, business efficiency and solvency. Moreover, they are also younger and pay lower tax on profit than SMEs, which perceive administrative barriers to a lesser extent.

According to the presented results, it is established that there exist a significant relationship between tax-related administrative barriers and SMEs characteristics. Namely, the greater extent of administrative barriers perceived, the lower is the performance of SMEs. Reducing those barriers may therefore encourage entrepreneurship. The aforementioned is very important, especially in small economies such as Slovenia where SMEs provide a solid source of job creation and economic growth. Although Slovenia strives to make continuous improvements in simplifying legislation and procedures in the field of tax compliance and financial reporting, there still remains room for improvements in terms of designing tax policy as well as tax and accounting rules in order to address all tax-related challenges faced by SMEs. It is important, that regulatory authorities bear in mind that complexity of tax-related administrative barriers have a price resulting in deterioration of the business environment for SMEs and their performance. In this context, the implementation of the European Small Business Act is extremely important, emphasizing a critical view when adopting legislation and policies.

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