

Financial Management Practices in Small and Medium Sized Enterprises: Empirical Evidence from the District of Ampara in Sri Lanka



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ABSTRACT

This research examines a study of financial management practices (FMP) in small and medium sized enterprises. The objectives are to evaluate the impact of working capital management, financial planning and control and total quality management system on financial management practices in the SME. The primary data are collected through standardized questionnaires from sixty owners of the SMEs in Ampara district of Sri Lanka. The collected data were analyzed by descriptive, correlation and regression analysis. With respect to the regression results, value for R square (0.513) indicates that working capital management, financial planning and control and total quality management system presents 51.3 percent of total variation of the dependent variable. Further results of this study indicate that working capital management and total quality management indicator positive significant relationship from regression tools while financial planning and control have a negative no significant relationship on financial management practices. This study suggests that government policies should be more effective and to provide the training programs for the owners and employees of SMEs. And also to eliminate the cash management difficulties, use effective inventory techniques, maintain the customers' creditworthiness and prepare the monthly review of actual achievements for the success of small medium sized enterprises in Sri Lanka.

Keywords: Planning, Control, Quality, Capital.

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1. INTRODUCTION

Since most managerial decisions are measured in financial terms, the financial management plays a key part in the company. The size and the importance of financial management depend on the company's size. In a small and medium size companies, the financial manager's obligations are generally carried out by the accounting department. The basic purpose of the financial management's actions has to be company's survival and implicitly its situation's consolidation, demonstrated by getting some worthy market performances. There are thousands of financial management practices in the business environment, but the organizations use some of them. Small and medium scale enterprises (SMEs) play very important roles in the process of industrialization and sustainable economic growth (Terungwa, 2012).

Small and medium enterprises grew in importance in the global economy during the last couple of decades. Financial management is crucial to the continuity of small and medium enterprises (SMEs). The growing importance of this issue raises interesting questions whether companies are improving their abilities to have effective financial management and implementing changes that will enable them to analyze results, to interpret, to forecast future performance and improve their business decisions (Barker, 2003). SMEs are currently being faced with many serious difficulties such as shortage of capital for expanding and renovating equipment and technology, low productivity and competitiveness, lack of experience in terms of marketing, production management, and financial management. Of these difficulties, lack of financial resources and experience of financial management is currently one of the most serious issues. Numbers of studies have concluded that the practice and implementation of good management are a key ingredient to a firm's success (Ghosh, 1993; Yusuf, 1995).

A large number of business failures have been due to the inability of the financial managers to properly plan and control their current assets and current liabilities within their organizations (Smith, 1973). Implementing an effective working capital management system is an excellent way for many companies to improve their earnings. Efficient working capital management is necessary for achieving both liquidity and profitability of a company.

Financial planning and control systems should be used by all enterprises including SMEs. Research indicates that there is a widely held view that many new businesses fail at a startling rate (Monk, 2000; Perry, 2001; Van, 2003; Radipere and Van, 2005; Van, 2005; Carter and Van, 2006; Gruber, 2007).

Financial planning and control of the average constitute a major part of every management's decision. There is no industry that can exist without fair planning and control of its finance. The organizations engage in financial planning and control to minimize expenses and maximize profit for more effective and efficient management to reduce industrial accidents and waste of resources.

The financial management practices are used by the small medium enterprises (SMEs). Some of SMEs earns more profit than some other large scale organizations. Therefore the reasons may be arising from how extent effective use of financial management practices among the organizations. Studies on financial management practices of SMEs are very scarce. Among the studies which explore the weaknesses in the management areas of SMEs is by Hashim and Wafa (2002). The survival of a business organization totally depends on effective financial management decisions. Most SMEs have not appointed financial managers to be in charge of financial management of the company. They indicated that if any enterprise, which includes SMEs, wishes to be successful in the current market, it needs to rethink the role its planning practices play in the organization. Hilton (2006) claim that lack of financial resources and experience of financial management is currently one of the most serious issues.

Lacks of knowledge of financial management combined with the uncertainty of the business environment often lead SMEs to serious problems regarding financial performances. Regardless of whether an owner - manager or hired - manager, if the financial decisions are wrong, profitability of the company will be adversely affected. Consequently, SME profitability could be damaged because of inefficient financial management (Noor and Mohd, 2011; Abanis, 2013; Gilbert, 2013; Irena, 2013; Deresse, 2014; Hakeem, 2014; Mintah, 2014).

1.2. Problem Statement

Moreover, during the economic downturn, small companies have to change their attitudes to be more competitive in the environment. Those companies have to meet the customers' requirements and need to

provide good products and services. As a result, the management has to make faster decisions to improve the efficiency and effectiveness of the business activities.

A number of studies have been conducted abroad and in Southern Africa on the reasons for the failure of small businesses (McMahon, 1993; Lussier and Pfeifer, 2001; Barker, 2003; Headd, 2003; Kieu, 2004; Macleod and Terblanche, 2005; Shahwan and Al-Ain, 2008; Sian and Roberts, 2009).

Lack of budgeting and financial discipline led to failure or poor performance of SMEs. Many entrepreneurs start businesses with hardly any capital and in addition, often have little or no management training or skills. They do not know how to plan and control the activities of their businesses, and as a result, they do not survive in this competitive market (Waweru, 2007). Ismail (2005) also found that small companies have little management accounting information and poor control and decision making is mostly on an informal basis. Findings from the study show that about 20 percent of the companies do not prepare income statement and cash flow statement, 40 percent of respondents do not prepare a bank reconciliation and balance sheet and over 40 percent do not prepare an aging schedule and financial ratios. It has also been indicated in some studies, that the lack of proper planning is one of the major causes of firm failure (Schrader, 1989; Perry, 2001). Financial planning is a very important survival tool both in the corporate and SMEs world. Financial planning practices should be used by all enterprises, including Small and Medium Enterprises. It has also been indicated in some studies, that the lack of proper planning is one of the major causes of SMEs failure (Schrader, 1989; Perry, 2001). According to Gibson and Cassar (2002) the management of these smaller firms has little or no understanding of the subject and those with lower educational levels are less likely to have plans. A research done by Beal and Abdullah (2002) revealed that out of 414 SMEs, only 7.2 percent have a high level of IT usage, 34.8 percent used some of IT and another 58.0 percent have not used IT at all. This indicates that the level of IT adoption is still very low among SMEs.

Lacks of knowledge of financial management combined with the uncertainty of the business environment often lead SMEs to serious problems regarding financial performances (El Luodi, 1998; Vuong, 1998). Because of that, these companies have to plan carefully and find an appropriate way to have good financial management hence to be able to use the information accurately. According to Petersen and Rajan (1997) a negative association arises when the level of working capital is linked to operational performance as measured by operational returns and margins. Most organizations have little reason to hold an optimal working capital and would rather increase the level of operating assets and increase the need for external funding. The end result would be a lower return on equity as well as asset without any increase in profit.

There are so many SME in the Sri Lanka. Some are profitable enterprises at the same time others are unprofitable. There has been a question on enterprises' performance, whether the reason for their profitability is using financial management practices effectively and efficiency or not. Until now there are no studies conducted regarding above aspect in Sri Lankan. Therefore, in order to fill the empirical gap this research will be study about that, what extent the financial management techniques are practiced among the small and medium enterprises in Sri Lanka.

In solving the research problem and answering the research questions mentioned previously, the objectives of this study are to find out the extent of practice of working capital management in the SMEs, to examine the level of usage of financial planning and control system in the SMEs and to evaluate the degree of application of total quality management system in SMEs.

2. METHODOLOGY

Conceptualizing is the process of giving clear idea and precise meaning and accepted definition of various concepts and variables used in the area of research undertaken. In order to study the financial management practice in the small medium enterprises. The independent and dependent variables are identified to build a relationship. Working capital management practice, financial planning and control practice and total quality management application as an independent variable and the extent of Financial Management Practices as a dependent variable. The following conceptual model was developed for the study.

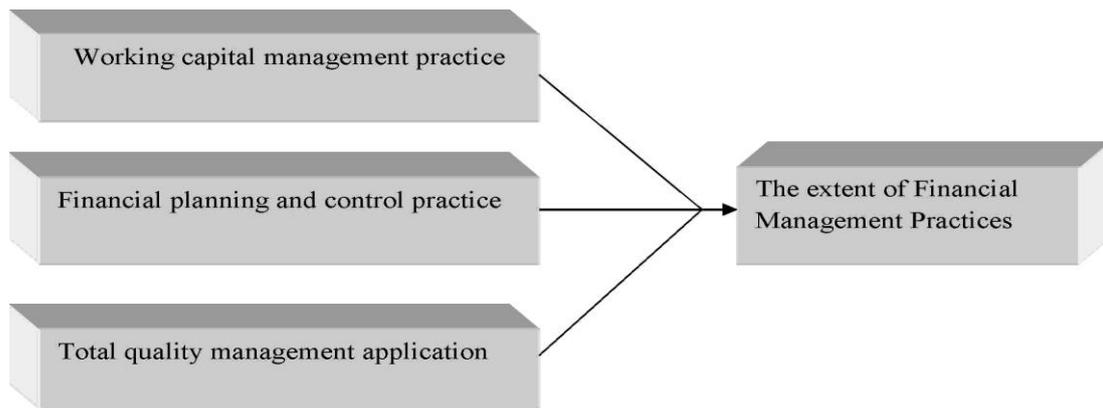


Figure-1. Conceptual Frame Work

Source: Researcher Develop

Financial planning and control (FPC) practice: The financial planning and control systems are one of the factors that influence the survival of small businesses. Financial planning is a continuous process of directing and allocating financial resources to meet strategic goals and objectives. The output from financial planning takes the form of budgets. Financial control perhaps plays an even more important role than physical control, if one considers the overall importance of finance for a firm. Financial control deals with the establishment of 'standards' or 'norms' and then making provisions for reporting deviations from the norms for necessary management actions.

The study administered a total of 70 questionnaires to different small and medium enterprises such as trade, hotels & travel, textiles & footwear, services beverage food & tobacco and other in Ampara district of Sri Lanka. Out of the 70 questionnaires administered, 60 were collected fully filled and were used in the study. This represents a response rate of 85.71%. According to this study response rate of 50% is adequate for a study, 60% are good and 70% is excellent for a study. Therefore, this response rate was considered ideal and reliable for the study. In this study, different methods of statistical processing have been applied. Here, descriptive statistics, correlation and regression are used to analyze the data.

2.1. Data Presentation and Analysis

Descriptive statistics are used to describe the basic features of the data in a study provide simple summaries about the sample and the measures. These statistics define various characteristics of the variables like, mean value represents the average of all the values of a variable, and the median is the middle value of the series, which divides the arranged series into two equal parts in such a way that the number of observations smaller than the median is equal to the number greater than it.

The mode is the most commonly occurring value, rest maximum and minimum values of the group are also determined along with the standard deviation and skewness which expresses the degree to which a variable is dispersed around its mean value, and the degree of asymmetry of a distribution around its mean value respectively.

If any variable has less than zero value in skewness measure, then that variable illustrates negatively skewed and vice versa. Kurtosis is nothing but it characterizes the peak level or flat level of a distribution compared with a normal distribution, where positive kurtosis illustrates the peak level and negative kurtosis confirms flat levels of a distribution, and range is a subtract the large value in to smallest value.

The reliability of the instrument was measured using cronbach's Alpha analysis. It measures the internal consistency of the instrument, based on the average inter-item correlation. An overall alpha reliability coefficient of 0.70 or higher is considered "acceptable" in most social science research situations.

Table-1. Descriptive Statistics of the Variable

	Gender	Age level	Educational	Type of industry	Business started	Source of capital	Computer use	Bank	Fixed assets	No of employees
N Valid	60	60	60	60	60	60	60	60	60	60
Missing	0	0	0	0	0	0	0	0	0	0
Mean	1.22	3.47	2.13	3.78	2.95	1.43	1.70	1.45	1.43	4.68
Median	1.00	4.00	2.00	3.50	3.00	1.00	2.00	1.00	1.00	3.00
Mode	1	4	1	6	3	1	2	1	1	2
Std. Deviation	.415	.853	1.096	1.708	.852	.745	.462	.502	.500	3.525
Variance	.173	.728	1.202	2.918	.726	.555	.214	.252	.250	12.423
Skewness	1.411	-1.588	.765	.055	-.243	1.382	-.895	.206	.276	1.158
Std. Error of Skewness	.309	.309	.309	.309	.309	.309	.309	.309	.309	.309
Kurtosis	-.011	1.730	.239	-1.317	-.859	.289	-1.241	-2.026	-1.991	.732
Std. Error of Kurtosis	.608	.608	.608	.608	.608	.608	.608	.608	.608	.608
Range	1	3	4	5	3	2	1	1	1	14
Minimum	1	1	1	1	1	1	1	1	1	1
Maximum	2	4	5	6	4	3	2	2	2	15

Source: Data analysis results

This research shows the results of cronbach's alpha (α) values are such as working capital management (WCM) 0.757, financial planning and control (FPC) 0.929, total quality management (TQM) 0.602 and financial management practices (FMP) 0.910. Unfortunately for this TQM research obtained 0.602 that is less than the cronbach's alpha value 0.70. To increase the alpha of TQM the variety of product innovation under the TQM was dropped to increase it. Thus the TQM cronbach's alpha increased from 0.602 to 0.805.

In statistics, correlation (often measured as a correlation coefficient, r) indicated the strength and direction of a linear relationship between two variables. Here used the correlation analysis to examine the relationship between dependent and independent variables. The following table 2 shows the correlation coefficient among selected variables which have independent and dependent variable.

Table-2. Pearson Coefficient of Correlation Matrix

		WCM	FPC	TQM	FMP
WCM	Pearson Correlation Sig. (2-tailed) N	1			
FPC	Pearson Correlation Sig. (2-tailed) N	.452**	1		
		.000			
		60			
TQM	Pearson Correlation Sig. (2-tailed) N	.688**	.427**	1	
		.000	.001		
		60	60		
FMP	Pearson Correlation Sig. (2-tailed) N	.703**	.308*	.620**	1
		.000	.017	.000	
		60	60	60	

** . Correlation is significant at the 0.01 level (2-tailed).

* . Correlation is significant at the 0.05 level (2-tailed).

Source: Data analysis results

Table 2 shows a highly positive relationship ($p < 0.001$, $r = 0.703$) between financial management practices (FMP) and working capital management (WCM) which is significant at the 1% level. The coefficient of correlation shows that there is a positive and significant relationship between FMP and WCM. The correlation between FMP indicator and financial planning and control (FPC) practices is positive significant because the values of the FMP and FPC Indicator is 0.308 which is significant at the 5% level. The coefficient shows that there is a positive and significant relationship between FMP and FPC. Results show a positive relationship ($p < 0.001$, $r = 0.620$) between FMP and total quality management (TQM) which is significant at the 1% level. The coefficient of Correlation shows that there is a positive and significant relationship between FMP and TQM.

This study employs a multiple regression model to investigate the relationship of the independent and dependent variable. In Addition to correlation tool, The Durbin – Watson, Tolerance & Variance Inflation Factor (VIF) are used for regression tool to check the multicollinearity in this study.

Table-3. Auto correlation and Multicollinearity

Variables	Multicollinearity Statistics		Durbin Watson
	Tolerance	VIF	
WCM	.496	2.015	1.975
FPC	.770	1.299	
TQM	.510	1.962	
WCM	.496	2.015	

Source: Data analysis results

The value of Durbin -Watson indicator is said that there is a no auto correlation because of according to table 3 shows that the Durbin – Watson Value is 1.975. The tolerance values of all selected independent variables are less than 1 and VIF values of all selected independent variables are less than 10. Therefore, there is no multicollinearity among selected independent variables of this study from three indicators.

This research employs regression analysis to measure the financial management practices in small and medium enterprises. The relationship between dependent and independent variable of the study estimated using the ordinary least square method is reported.

Table-4. Model Summary

R	R Square	Adjusted R Square	F	Sig.
.729 ^a	.531	.531	21.15	.000 ^a

a. Predictors: (Constant), TQM, FPC, WCM

Source: Data analysis results

Findings from the regression analysis result for the selected SME as depicted in Table 4 indicates that, 72.9% of the variability in financial management practices in small and medium enterprises is explained by these variables. This means the model fit is adequate. As such the rest that is 27.1% is unexplained by this model. This is an overall measure of the strength of association and does not reflect the extent to which any particular independent variable is associated with the dependent variable. The R square value is 53.1%. This means that the independent variables explain 53.1% of the variance of the dependent variable. The rest 46.9% are explained by other factors which are not considered in this study.

Findings indicate that, the F value is 21.152 and the p-value is 0.000 which is less than 0.05. This invariably suggests clearly that simultaneously the explanatory variables are significantly associated with the dependent variable. That is, they strongly determine financial management practices in small and medium enterprises.

Table-5. Coefficients

Variable	Standardized Coefficients Beta
Constant	-1.622
WCM	.539
FPC	-.052
TQM	.271

Source: Data analysis results

Above Table 5 shows the beta coefficient of WCM is 0.539 which is significant level. The coefficient shows that there is positive significant impact of working capital management indicator of financial management practices. The beta coefficient of FPC is - 0.052 which is insignificant level. It means that there is no significant impact of financial planning and control on financial management practices. The beta coefficient of TQM is 0.271 which is significant level. The coefficient shows that there is positive significant impact of total quality management indicator of financial management practices. Therefore, the multiple regression model is as follows:

$$Y (FMP) = - 1.622 + 0.539 (WCM) - 0.052 (FPC) + 0.271 (TQM) + e$$

Previous studies on financial management practices in small and medium enterprises were reviewed. A number of studies have found that a relationship exists of financial management practices between small and medium enterprises. Such as [Abanis \(2013\)](#); [Mintah \(2014\)](#); [Irena \(2013\)](#); [Hakeem \(2014\)](#); [Gilbert \(2013\)](#); [Deresse \(2014\)](#); [Noor and Mohd \(2011\)](#) these studies have provided different results. The results of the previous studies have changed according to the dependent and independent variables used, the research methodology employed and the countries examined.

3. CONCLUSION AND RECOMMENDATIONS

Small and medium enterprises continue to play important roles in developing the multi-sector economy and the government has policies to promote and support the development of SMEs. The purpose of this

research is to find out the extent of practice of working capital management practiced in the SME, to examine the level of usage of financial planning and control system in the SME and to evaluate the degree of application of total quality management system in the SME.

The correlation tool is also used in this study to analyze the relationship between liquidity and profitability to give conclusions each hypothesis developed from correlation tools. The coefficient of Correlation shows that there is a positive and significant relationship between financial management practices (FMP) and working capital management (WCM). The correlation between financial planning and control (FPC) practices is positive significant values of FMP. The coefficient of Correlation shows that there is a positive and significant relationship between FMP and Total quality management (TQM).

Based on the regression analysis, finding is discovered 53.1% of variation in FMP is explained by WCM and TQM variables and remaining 46.9% may be caused by other non-selected variables in this study. This study investigated on financial management practices in small and medium enterprises. The results of this study indicate that financial planning and control have a negative relationship on financial management practices from regression tools while working capital management and total quality management indicator positive relationship on financial management practices in small and medium enterprises.

From this study recommending that government policies will be more effective if the policy-makers understand current practices of financial management of SMEs. The government will provide the training programs in financial management skills and financial software for the owners and employees of SMEs. To eliminate the cash management difficulties faced by small businesses. Customers' credit worthiness should be assessed before credit is given. The effective inventory technique should be applied by small scale businesses. Prepare the monthly joint review of actual achievements with the budgeted/target figures. The study will also help to determine the extent to which basic accounting procedures and financial practice have been implemented and applied in SMEs. Moreover, it will aid in identifying the consequences of failing to give financial reports.

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