Impact of Financial Management Practices on Financial Performance of SMEs in Sri Lanka: Evidence from Anuradhapura District

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Introduction

Small and Medium Scale Enterprises (SMEs) which have been recognized as a strategically vital sector in the economy of Sri Lanka contribute in generating high economic growth, employment generation, improving innovation capabilities and regional development. Thus, this sector is considered as the backbone of the Sri Lankan economy (Gamage 2014).Therefore, policy makers, practitioners and researchers in all relevant institutions have a huge responsibility to groom small businesses to become large scale export firms which is essential for economic development in Sri Lanka (Gamage 2014).Financial management (FM) system is necessary to ensure that the SMEs economic resources are used effectively and efficiently in search of its goals (Butt, Hunjra & Rehman 2010). However, poor recordkeeping, inefficient use of accounting information to support their financial decision making and the low quality and reliability of financial data are part of the main problems in FM concerns of SMEs (Karunananda & Jayamaha 2011). According to Turyahebwa, Sunday and Ssekajugo (2013), financial management practices positively influence on firm performance of SMEs. Therefore, it is utmost important to analyze the firm performance and FM practices of SMEs. In practice, this study was significant for financial management practices in Sri Lanka. The results will indicate the relationships between financial management practices and SMEs performance and will assist owner-managers and financial managers to improve performance and profitability of their businesses by managing financial matters efficiently and effectively. Through this study an effort is made to ascertain the financial practices adopted by SMEs in Sri Lanka and get to know whether those practices have an impact on these firms' financial performance.

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Literature Review

FM is one of several functional areas of management, but it is central to the success of any small business (Meredith 1986 cited in Abanis et al. 2013). FM is the management of finances of a business in order to achieve the financial objectives of the business. Financial literature suggests that optimum application and commitment towards financial management practices is one of the successive factors resulted on firms' performance (Butt et al. 2010;Jennifer & Dennis 2015).The financially well-managed firms are operationally efficient (Butt et al. 2010).The ability of SMEs to develop, grow, sustain and strengthen themselves is heavily determined by their capacity to access and manage finance (Abe, Troilo & Batsaikhan 2015).Inefficiencies in FM result in poor financial performance and eventually lead to failure of SMEs (Jennifer & Dennis 2015). Accounting information system (AIS) as one of the key FM practices, reported that there is a positive and significant impact on firm's performance (Turyahebwa et al. 2013; Jennifer&Dennis 2015).Working capital management (WCM) is important since it affects on the firm's profitability, risk and eventually its value. Many studies noted that WCM significantly and positively influence on firm's performance (Butt et al. 2010; Niazi et al. 2011; Jennifer &Dennis 2015). Bookkeeping alone without preparing reports is likely not to be fundamental in aiding decision making unless proper reports are prepared and analyzed to attach a meaning so as to help decision makers (Abanis et al. 2013; Jennifer &Dennis 2015). Financial reporting and analysis (FRA) as another FM practice show a significant and positive impact on firm's performance (Turyahebwa et al. 2013; Jennifer& Dennis 2015).

Methodology

The sample consists of 50 firms from the SMEs operating their business in Anuradhapura District through a random procedure for the year ended 2014. A field survey with a standard and self-reported questionnaire is administered to garner data. The entire sample is the final sample since, one of the researchers herself collect the data through the field survey. Thus, the response rate is 100%. Three variables are identified as FM practices; AIS, WCM and FRA whereas return on equity (ROE) is used as the proxy for the firm performance. A multiple linear regression model attempts to investigate the association between firms' performance and their FM practices using the statistical package SPSS.

$$\text{Performance ROE} = \alpha + \beta_1 AIS + \beta_2 WCM + \beta_3 FRA + \varepsilon \quad (1)$$

Results and Discussion

Table 1 depicts some important descriptive statistics of the relevant variables.

Table 1: Results of Descriptive Statistics

	Minimum	Maximum	Mean	Std. Deviation
ROE	47.69	51.75	50.00	0.99
AIS	3.25	5.00	3.96	0.39
WCM	2.57	3.57	3.08	0.28
FRA	2.86	4.29	3.45	0.29

Source: Analysis Data

Researchers performed an Ordinary Least Square (OLS) regression analyses for all variables and results are presented in Table 2. The R Square value represents that only 20.5% of the variation in dependent variable can be explained by the respective independent variables. Thus, R Square shows the evidence for the badness of fit of the model. Table shows the estimation for the link with ROE as the measure for firms' performance. In this study, only WCM significantly affect on firm performance of the selected firms. The result is consistence with the findings of previous researchers (Butt et al. 2010; Niazi et al. 2011; Jennifer & Dennis 2015). According to the regression results, the effects of AIS and FRA on firm performance were not significant. Thus, the findings are a little bit contrast with the prior studies may be due to small sample or country difference.

Table 2: Results of Regression

Variables	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
Constant	42.500	2.199		19.326	0.000
AIS	0.392	0.339	0.157	1.157	0.253
WCM	1.327	0.602	0.314	2.204	0.033
FRA	0.470	0.470	0.141	1.001	0.322
R= 0. 452	R square = 0. 205		Adj. R square = 0. 153		
SE = 0. 903	F value = 3.945		Sig F = 0. 014		

Source: Analysis Data

Conclusion and Recommendations

The result of the regression analysis is obvious that firms' performance in SMEs affects only by the WCM when performance is measured by ROE. The coefficients representing WCM, in ROE is positively and statistically significant at the 5% level. However, performance of SMEs does not influence by AIS and its coefficient is not statistically significant. FRA also is not a significant factor that contributes to the profitability of sample firms. Thus, it is apparent that performance of selected firms affects only by one of the selected FM practices. On the whole, the results imply that FM practices employed in this study have only a small contribution on the performance of Sri Lankan SMEs. Some limitations of this study are also inevitable. Other variables which may effect to the performance have not been included in the models was the main limitations of the study. It would probably be able to increase the power of the regression models by adding more independent variables, and hence a better explanation of the FM practices of the SMEs' performance.

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