

Impact of Financial Management Practices on Performance of Small and Medium Enterprises – Legitimacy Theory Perspectives

Tharmini T¹., Lakshan A.M.I.²

¹National Audit Office, Sri Lanka

²University of Kelaniya, Sri Lanka

¹ttharmini18@gmail.com, ²lakshan@kln.ac.lk

The study aims to find out the impact of financial management practices (FMPs) on performance of Small and medium enterprises (SMEs) in Sri Lanka from the lens of the Legitimacy Theory. Primary data was collected from the SME owners/managers. Self-administered questionnaires were issued to collect data. The sample was selected through stratified simple random sampling method from the registered SMEs. Data were analyzed and evaluated by using Descriptive Statistics, Independent sample t-test, Correlation analysis and regression analysis. The results revealed that Accounting Information System, Financial reporting and analysis has moderate level adoption, Working capital management has high level adoption and Financial planning and control has low level of adoption in SMEs. Further, Financial reporting and analysis and Working capital management is significantly impact on the performance of SMEs. Accounting Information system and financial planning and control is not significantly impact on performance of SMEs. The findings revealed that there is a significant difference in the application of FMPs among small sized enterprises and medium sized enterprises. FMPs are highly applied by medium sized enterprises than small sized enterprises. The study also found out that lack of accounting knowledge and cost of hiring professional accountants are the major challenges faced by SMEs to adopt the FMPs.

Eventually, this study recommends to SME owners to adopt FMPs (at a higher level) and government and other regulatory bodies to create suitable policies and standards to mitigate the challenges. SMEs practice important FMPs to obtain the society's impression as social responsible organizations (in terms of legitimacy within 'social contract'). Accordingly, application of FMPs aims to legitimise company behaviour by ensuring the profitability, survival and growth to influence the society's perceptions about the SMEs by way of higher number of employments, use of domestic raw materials and payment of taxes. This study contributes to the theory by bringing in SMEs perspectives in to the Legitimacy theory. Further, it contributes to practice and literature by carrying new insights on the impact of FMPs on performance of SMEs in the Sri Lankan context.

Keywords: Small and Medium Enterprises (SMEs), Performance, Accounting Information System, Financial planning and control, Financial reporting and analysis, Working capital management, Legitimacy Theory

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Correspondence: lakshan@kln.ac.lk

ORCID of authors: Lakshan A.M.I. -  <https://orcid.org/0000-0003-4469-6671>

DOI: <http://doi.org/10.4038/kjm.v10i1.7666>



Background

The Small and Medium Enterprise (SME) sector is the backbone of all developed and developing nations. According to the National Policy Framework for SME Development in Sri Lanka (2016), the SME sector plays a vital role in the socio economic aspects of a country and is considered as the backbone of an economy and it is estimated that the SMEs accounts for over 90% of the total enterprises, 45% of the total employment and make a significant contribution to the Gross Domestic Product. SMEs contribute a large part of Sri Lanka's economy, accounting for 80% of all businesses. These are found in all primary, secondary and tertiary economy and provide employment for the persons of different skilled, semi-skilled and unskilled (Wickramatilake, 2018). Even though SME role is considered as substantial in the economy, many SMEs are troubled by management problems such as human resource management, financial management, operations management, marketing management and strategic management, etc. (Hashim & Wafa, 2002). Financial constraints can be recognized as the main issue when considering about the issues faced by the SMEs (Amoako, 2013).

Financial management is taken into account as the most significant management skills for a SME because it affects each functions of the entrepreneurial venture (Watson, 2004). Financial management helps to minimize the costs, maximize the profit, and plan and control the financial assets of the firm (Bloom & Boessenkool, 2002). For the survival and wellbeing of the business, financial management is taken into account as a key aspect and it is a managerial activity concerned with the planning and controlling of the firm's financial resources (Pandey, 2004). SMEs often faced accounting and financial management challenges due to poor keeping of records, inefficient use of accounting information for financial decision making and the low quality and reliability of financial data

(Sarapaivanich, 2003). The poorly recorded inaccurate accounting information leads SMEs to measure their financial situation inaccurately and make poor financial decisions. In the worst case, most SMEs might fail and perhaps bankrupt at the end (Stice et al. 1999). Part of the main problems in financial management in SMEs include poor record-keeping, low quality and reliability of financial data and inefficient use of proper accounting information to support their financial decision making (Karunanada and Jeyamaha 2010). Further, SMEs will not be able to concentrate on external financing like bank loans since their poor financial record keeping and non-maintenance of the accounts. When applying for a loan, audited financial statements should be supplied with collateral. As a result of not maintaining the records, obtaining a credit has been a challenge (Amoako, 2013). The main reason for SMEs failure is that the poor financial management (Arinaitwe, 2006; Muchira 2012). SMEs have inadequate financial management and accounting systems those are different from the large firms and also have inadequate skilled employees to manage the funds (Muneer, 2017; Kilomzo & Ouma, 2015; Turyahebwa, 2013). Poor or lack of proper bookkeeping and accounting practices which are components of financial management practices is one of the major reasons for the collapse of SMEs (Bowen, 2009; Germain 2010; Kitinga, 2013). Therefore, it is important to examine the financial management practices and performance of SMEs in Sri Lanka as SMEs are contributing much more to the economic growth of the country. Therefore, this study is an attempt to identify the financial management practices adopted by SMEs to assess whether the financial management practices has an impact on the performance of SMEs.

Statement of the Problem

According to the National Policy Framework for SME Development in Sri



Lanka (2016), SMEs are considered as the significant sector to the employment generation and Gross Domestic Product. And the Government has identified that this sector as a thrust area that should be developed to provide employment to uplift the living standards of the people. Most of the SMEs face difficulties to run the business for a long time with success. Inadequate financial management decisions and accounting information have been mentioned consistently as causes of small and medium enterprises failure (Adjei-Sarpong, 2012). Finance, management skills, macro-environment factors and infrastructure have been viewed as challenges facing SMEs performance.

Most SMEs do not have financial managers to be in charge of financial management of the business. Usually, the owners of the SMEs manage and control financial matters of the business. However, they do not have adequate knowledge and proper training to do the financial management practices of the business. Therefore, currently financial management is one of the challenges faced by SMEs. Even though Chartered Accountants of Sri Lanka (CASL) adopted the IFRS for SMEs from 2012, we still can see there is a noncompliance with those standards in real working environment. (Abeygunasekera & Fonseka, 2012; Sandamali .et.al, 2018; Wijekoon, 2018). Unfortunately, most of SMEs lack funding from banks and other financial institutions because this sector is like to be a high risk investment area due to there is bad financial management practices. So, the poor financial management practices often lead SMEs to serious problems regarding the performance of SMEs. SMEs largely contribute to the livelihood of the people. However, there is a lack of investigation on the financial management practices and SMEs performance. Therefore, this study is carried out in order to identify the adoption of financial management practices in small and medium sized enterprises and impact of financial management practices on the

performance of SMEs in Sri Lanka. The specific objectives of the study are as below:

1. To find out the extent of financial management practices adopted by the SMEs.
2. To find out the impact of financial management practices on performance of SMEs.
3. To find out the differences in the usage of financial management practices among the Small sized enterprises and medium sized enterprises.
4. To identify reasons for the adoption of financial management practices by the SMEs.
5. To identify the challenges faced by SMEs to adopt the financial management practices.

Significance of the Study

This study attempts to provide better understanding of the usage of financial management practices of SMEs operating in Batticaloa district, Sri Lanka and their impact on the performance of SMEs.

Practically, this study is significant to the SMEs owners, who might not be knowledgeable of the importance of the financial management practices. It helps to provide them insights as to how they may improve their organizational performance by having well managed financial management practices. And SME owners who currently struggle with financial difficulties such as lack of knowledge, concerning sources of funds, handling expenditures and financial management may gain insight from the findings of the study.

This study may bring significant contribution through creating positive awareness of financial management that may help business owners manage their funds effectively and expand their businesses to the next stage of development, thereby improving the well-being of people living in their society. The findings of the study help to understand the extent of using the financial management practices by



SMEs. It will help to the regulatory bodies and policy makers of SMEs to understand how the financial management practices impact the SMEs growth and identify the challenges faced by SMEs to adopt the financial management practices. It will directly help them to develop the new policies and trainings to SME owners to adopt the financial management practices. Therefore, the finding of the study helps to the future researchers who are undertaking similar topics on other related topics. Further, the findings will assist owners to improve performance of their business by managing the financial matters effectively and efficiently.

This study has added new insights in to the theoretical perspectives: Legitimacy theory. The study has discussed the findings from the Legitimacy theory perspectives and asserts that the SMEs apply good financial management practices to satisfy rights of the public at large, not merely those of its investors. This is protecting the 'social contract' between the organizations in question (SME) and the society in which it operates. Further, the findings emphasize that the scope of 'social contract' depends on the size of the SME. These perceptions are new insights of the research which are not available in the prevailing literature of Legitimacy theory.

Literature Review and Hypotheses Development

Definition of SMEs

One problem faced by the SME sector is that there is no proper definition for SMEs. This problem is not unique to Sri Lanka, but it is common to many countries around the world, as classifications an SME can be on a multitude of variables that can differ from one country to another. However, due to the absence of a nationally accepted definition for SMEs and the unavailability of information, it is difficult to determine the clear cut definition of SMEs (Thrikawala, 2009). Therefore, not only do

different countries apply different definitions on the concept of SMEs, but even within countries, different regions and different institutions adopt varying definitions in this regard. Number of employees, the size of fixed investment, capital employed and the nature of the business and the sector are considered as the criteria to define the SMEs.

According to World Bank criteria any enterprise having below 99 people can be termed as SME. The Industrial Development Board identifies an SME as an institution whose capital investment in plant and machinery does not exceed Rs.4 million (Gamage, 2003). The Department of Census and Statistics also determines an SME by using the number of employees, where the organizations with up to 149 employees are considered medium scale businesses. According to the Task Force for Small and Medium Enterprise Sector Development established in December 2002, an SME is defined as an entity with less than an investment of 50 Million and employs less than 30 employees. It is obvious that the number of definitions for SMEs used by several institutions had led to a misunderstanding in identifying SMEs for a number of supportive measures (Gamage, 2003).

Currently, Sri Lanka has not uniformly defined which criteria a business has to fulfil to be viewed as an SME. Therefore, this study intends to consider the Federation of Chambers of Commerce and Industry of Sri Lanka definition. The Federation of Chambers of Commerce and Industry of Sri Lanka defines the small and medium enterprise based on the capital employed by the business. Capital employed is the most widely used measure of size in quantitative definition for SMEs. Accordingly, the study uses the following definition for SMEs demarcating, small and medium enterprises;

Small business – Less than Rs.2 million capital employed



Medium business – Between Rs.2 million to Rs.20 million capital employed.

Theoretical Perspective - Legitimacy Theory

Legitimacy theory sometimes referred to as a one of 'systems-oriented theories'. The theory focuses on the whole society and not just a particular group as happened in stakeholder theory (Deegan, 2002). In systems based perspectives, an entity is assumed to be influenced and to have influenced upon, the wider society in which it conducts its operations. Legitimacy theory has derived from the wider theory; the political economy theory (Gray, Owen and Adams, 1996). Political economy theory has a wider scope and has been defined as 'the social, political and economic framework within which human life takes place' (Gray, Owen and Adams, 1996, p.47). Discussion of SMEs activities from the theoretical lens of a root of wider political economy theory could bring several insights in to the practice.

As compressed within the 'social contract', Legitimacy theory deliberates expectations of the society. The theory asserts that organizations try to ensure that they operate within the bounds and norms of their operating societies. This is to confirm that their activities have been perceived as 'legitimate' by the stakeholders. 'Social contract' between the organization (SME) and the society in which it operates is the concept which relies upon the Legitimacy theory (Deegan, 2001). The concept existence of 'social contract' is common to both the Legitimacy theory and Stakeholder theory. It declares a firm is responsible and accountable to its stakeholders (Gray et al., 1996).

It is hypothesised that the society allows an organization to continue its operations until and to the extent it meets the expectations of the society. The society includes wider stakeholders. Legitimacy theory emphasizes that the organization must consider rights of the wider stakeholders, not merely its

investors. Therefore, practices and behaviours of organizations (SMEs) are being observed by the wider stakeholders.

Legitimacy theory suggests that Financial Management practices are functions of the level of political and social pressure with which companies (including SMEs) face concerning their performance. In response to these pressures, firms react by practising more Financial management practices in order to preserve their image of being a legitimate entity, to avoid the negative consequences caused by legitimacy crises and achieve their expected business growth.

Accounting Information System

Results of the study of Esmeray (2013) revealed that accounting information system has a positive effect on the performance of the SMEs in Turkish. At the same time Belal (2013) investigated the use of Accounting Information of Small and Medium Enterprises in Jordan and recommended that good accounting practices will improve the effective operations of small and medium scale enterprises. Turyahebwa, et.al, (2013) examined financial management practices and business performance of SMEs in western Uganda and revealed that there is a positive and significant correlation between accounting information system and business performance. According to the previous studies it shows that there is a positive impact between accounting information system and performance of SMEs in other countries. Tharindi & Rathnayaka's (2016) study based on Financial Management Practices of SMEs in Sri Lanka found that there is a positive relationship between accounting information system and financial performance of SMEs. It indicates when the firm is having an efficient accounting information system that leads to enhance the financial performances of the SMEs. However, Uduwaka & Dedunu, (2019) examined the effect of financial management practices on financial performances of SMEs and revealed that there is no significant positive impact of



accounting information system on the financial performance of SMEs.

Financial Reporting and Analysis

McMahon and Adelaide (1995) study based on Australian SMEs revealed that improvement in financial reporting leads SMEs effective and efficient management and significantly improve their prospects. Turyahebwa, et.al's (2013) study based on western Uganda SMEs revealed that there is a positive and significant correlation between financing practices and business performance. It indicates that efficient financial reporting and analysis is highly associated with high business performance. However, Yogendrarajah, Kengatharan, & Suganya (2017) investigated the Financial management practices and performance of SMEs in Sri Lanka and postulate that there is no significant impact of financial reporting and analysis on performance of SMEs.

Working Capital Management

Kenyan based study by Nyamao, Lumumba, Oondo & Otieno (2012) found that working capital management practices were low amongst small-scale enterprises as majority of them had not adopted formal working capital management routines. And the study revealed that working capital management influences the financial performance of small scale enterprise.

Hamza et al, (2015) investigated the cash management practices and performance of SMEs in Northern Region of Ghana and the findings revealed that the cash management efficiency had a positive impact in ensuring that the SMEs were successful. Oluoch, (2016) conducted a study on the impact of cash management practice on the returns of the SMEs. The findings revealed that the cash management practices had a significant positive impact on the performance.

Tharindi & Rathnayaka, (2016) investigated Financial Management Practices and Performance of Small and Medium

Enterprises in Sri Lanka and revealed that there is a positive relationship between working capital management and financial performance of SMEs in Sri Lanka. Lakshan (2009) found that shorter accounts receivable period enhances the profitability of manufacturing sector small and medium sized enterprises. Lazaridis & Dimitrios (2005) investigate the relation between working capital management and corporate profitability of listed company in the Athens Stock Exchange. The results indicated that there was a statistical significant positive relationship between profitability, measured through gross operating profit, and the cash conversion cycle. Turyahebwa, et.al, (2013) investigated financial management practices and business performance of small and medium enterprises in western Uganda. The findings of the study revealed that there is a positive and significant correlation between working capital management and business performance. This indicated that efficient management of working capital practices like receivables management, cash management and inventory management is highly associated with improved business performance among SMEs.

Financial Planning and Control

Musando (2013) found a significant positive relationship between financial planning and the financial performance in SMEs. Atieno, (2013) found that most SMEs practice financial planning practices such as activity-based budgeting, periodical budget estimations, and financial analysis. It indicated that financial planning practices had positive impacts on the performance of the SMEs and good capital maintenance, managing risks, increased the efficiency of operations. However, a study by Uduwaka & Dedunu, (2019) the effect of financial management practices on financial performances of small and medium enterprises in Sri Lanka revealed that financial planning had not impact on performance. According to the previous studies, the studies conducted in other country had a positive impact between



financial planning and control and performance of SMEs. However, the study conducted in Sri Lanka had a negative impact between financial planning and control and performance of SMEs.

Performance

Performance means how well the business is doing in wealth creation and acquiring of resources (Golda, 2013). Further, performance may be termed as the benefits gained from the work activities and business processes carried out by the organization (Khan, Khalique, & Nor, 2014). It may also be described by how well the business is doing for wealth creation and acquiring of resources (Golda, 2013). Success of an organization is measured through the performance of the organization financial performance and non-financial performance (Protapappa-Sieke and Seifert, 2010). Kennerley and Neely, (2002) stated that performance measurement can be effective in decision making because without performance measurement it's difficult to estimate the purpose of the organization.

According to Agarwal et al., (2003) organizational performance considered judgmental and objective performance are the two dimension of organization performance. Judgmental performance includes the employees and customers perceptions which are service quality, customer satisfaction and retention. And the Objective performance includes financial and market based assessments such as sales growth, profit, market share and efficiency. Abusa fuzi, (2011) summarized that measuring the organization performance classified as five categories. Those are financial performance, Operational Performance, customer satisfaction, Employee satisfaction and Learning and Growth. Entity's performance is determined based on both quantitative and qualitative measures. The quantitative measures focus on the financial aspect and health of the SMEs (Klewitz and Hensen, 2014). Return on Capital Employed, Return on Assets and

Return on Investment are the main measures of the financial management (McMahon, 2005).

Growth of the sales relates to improvement in overall organization returns and its ability to attain equilibrium with the surrounding environment (Gormoma, 2014). Ritab et al. (2004) in their research concluded that ROA taken into account of assets, being highly important for generating revenue. ROA have been used as an indicator of performance (Yammessri and Loth, 2004). This study focus on the financial performance to reflect the overall performance of SMEs. Operating profit and return on asset are measured in the financial performance.

Hypotheses

The above literature review proposes the hypotheses below:

H1: There is an impact of financial management practices on performance of SMEs.

H 1.1: There is a positive impact of Accounting Information Systems on performance of SMEs.

H 1.2: There is a positive impact of financial reporting and analysis on performance of SMEs.

H 1.3: There is a positive impact of Working capital management on performance of SMEs.

H 1.4: There is a positive impact of financial planning and control on performance of SMEs.

H 2: There is a significant difference in applying financial management practices among Small sized enterprises and Medium sized enterprises.

Efficient financial management practices are essential for SMEs to reach growth stage of the firm as it has major effect on performance (Kengatharan and Yogendrarajah, 2017). Financial



management characteristics influence on business growth and performance of SMEs (McMahon, R. G., 2001).

Methodology

Population of this study consists of registered SMEs from Divisional Secretariat of the Batticaloa district. The total population of the district is 1787 registered SMEs. A sample of 150 SMEs was selected. The sample was divided into homogeneous sub groups and these are called strata. This was done on the basis of the types of business. These included Retail business, Pharmacy, Electricals, Building material and furniture, Hotel or restaurant, Spare parts of Motor vehicles, Textiles and footwear, Wood and Iron furniture, Book shop, Liquor shop, Jewellery and Others. Sampling units were then selected from each stratum using the simple random sampling technique. Therefore, the sampling method used in this study is stratified simple random sampling. The primary data were collected through self-administrated questionnaires from the owners of those SMEs. A five point Likert scale was used to measure the variables and the scale consist of five boxes ranging from strongly disagree to strongly agree. The Multiple regression models has been used to test the impact of financial management practices (Accounting information system, Financial reporting and analysis, Working capital management and Financial planning and control) on performance of SMEs in Batticaloa District. This method involved mathematical equation;

$$Y_i = \beta_0 + B_1AIS + B_2FRA + B_3WCM + B_4FPC + Z_i$$

The independent sample t test was used to identify differentiation in the usage of financial management practices among SMEs. The moderating variable which is the size of the SME was introduced to the regression with all the variables. This tested the extent to which the prediction power of the model improved as a result of introduction of SME size to the equation.

The results (F=35.204, p <0.01) of Analysis of Variance (ANOVA) indicated that the regression model was significant. It means that the regression results were accepted for this analysis. A variance inflation factor (VIF) detects multicollinearity in regression analysis. Multicollinearity exists whenever an independent variable is highly correlated with one or more of the other independent variables in a multiple regression equation. The VIF estimates how much the variance of a regression coefficient is inflated due to multicollinearity in the model.

Results

A summary of demographic characteristics and business profile of respondents is given in the table below;

Table 1: Demographic characteristics and Business profile

Variables	Values	Frequency	Percent
Gender	Male	124	82.7
	Female	26	17.3
Age	Below 30	6	4.0
	30-40	55	36.7
	40-50	32	21.3
	Above 50	57	38.0
Educational Qualification	Below GCE O/L	8	5.3
	GCE O/L	37	24.7
	GCE A/L	62	41.3
	Any other degree/diploma	43	28.7
Business Profile	Retail Business	34	22.7
	Pharmacy	8	5.3
	Electricals	5	3.3
	Building	5	3.3



Type of Industry	material and Furniture		
	Hotel or Restaurant	10	6.7
	Spare part of motor vehicles	7	4.7
	Textile and footwear	34	22.7
	Wood and Iron furniture	4	2.7
	Book Shop	3	2.0
	Liquor Shop	2	1.3
	Jewellery	8	5.3
	Others	30	20.0
Number of years of operation	Less than 2 years	10	6.7
	2-5 years	36	24.0
	6-10 years	35	23.3
	More than 10 years	69	46.0
Capital Employed	Less than 2 million	67	44.7
	2-20 million	83	55.3
SME Legal Formation	Sole proprietorship	121	80.7
	Partnership	27	18.0
	Limited Company	2	1.3
Number of employees	0-5	89	59.3
	5-20	60	40.0
	20-50	1	0.7

According to table 01, higher percentages (82.7 %) of enterprises' owners were males running the business while females were only 17.3 %. The sample includes four age groups as: below 30, between 30-40 years, 40-50 and above 50. Majority of respondents (38%) were above 50. And the next highest level of respondents (36.7%) were belongs to the age group 30-40. The educational qualification of respondents were classified into four categories, and out of 150 respondents 5.3% of respondents are Below O/Level, 24.7% of respondents are

done O/Level, 41.3% of respondents are done A/Level and remaining 28.7 % of respondents are done any other degree or diploma.

In the business details, majority of the data is collected from the industries of retail business and textile and footwear industry. Out of respondents 22.7 % of the business includes in these both industries. Number of years of operation includes less than 2 years, 2-5 years, 6-10 years and more than 10 years.

Most of the enterprises were between the period of more than 10 years which was 46 % and 24 % of enterprises falls between of 2-5 years. 23.3 % of businesses were 6-10 years and 6.7 % were 6.7 %. From the data collected, it can be seen that 67 (44.7%) of enterprises were small sized enterprises and 83 (55.3%) of the enterprises were medium sized enterprises. Majority were said to have been in operations as a medium sized enterprise based on the amount of capital employed for the business in Batticaloa district. According to the sample 80.7 % of business formed as sole proprietorship, 18% of the business formed as partnership and only 1.3 % of the business formed as limited company. Therefore, the most preferred SMEs formation was found out to be sole proprietorship in Batticaloa district. According to the sample 4.9, there are 59.3 % of the business have 0-5 employees, 40 % of the business have 5-20 employees and 0.7 % of the business have 20-50 employees. This shows that majority of the SMEs had less than 5 employees in their business.

Reliability Analysis

Cronbach's alpha is used to measure the strength of the consistency. An accepted rule is that Coefficients of 0.6 - 0.7 indicates an acceptable level of reliability, and 0.8 or greater a very good level of internal consistency (Hulin, Netemeyer, and Cudeck, 2001).



The overall Cronbach’s alpha coefficient was 0.969 with respect to 46 statements. Therefore, all the items considered in this study are to be reliable, which suggest that the internal reliability of the instrument was satisfactory (Table 02).

Table 2: Reliability Analysis - Cronbach’s alpha

Variables	Cronbach’s alpha
Organizational performance	0.954
Accounting information system	0.951
Financial reporting and analysis	0.838
Working capital management	0.930
Financial planning and control	0.990
Firm Size	0.933

Extent of Financial Management Practices Adopted by SMEs

The mean value and standard deviation of the variables were taken into consideration in the analysis to find out the extent of financial management practices adopted by the SMEs.

According to Abanis (2013), the following decision criteria were applied; Low level ($1 \leq X_i \leq 2.5$), Moderate level ($2.5 < X_i \leq 3.5$) and High level ($3.5 < X_i \leq 5.0$).

Table 3: Adoption Level of Financial Management Practices

Variables	Mean	Standard Deviation
Accounting Information System	3.41	0.928
Financial Reporting and Analysis	3.27	1.072
Working Capital	3.85	0.735

Management		
Financial Planning and Control	1.98	1.217

According to the analysis, accounting information system and Financial Reporting and analysis practices have been adopted at the moderate level among the SMEs (Mean =3.41, Standard Deviation = 0.920; Mean =3.27, Standard Deviation = 1.072, respectively). Working capital management practices have been adopted in the high level among the SMEs (Mean =3.85, Standard Deviation = 0.735) and financial planning and controlling practices have been adopted at the low level among the SMEs in Batticaloa district (Mean =1.98, Standard Deviation = 1.217).

Correlations Analysis between Variables

Results of the table 04 indicate: the Accounting Information System had a Correlation value of 0.606 and a p-value of 0.000; Financial reporting and analysis had a Correlation of 0.665 and a p-value of 0.000; Working capital management had a Correlation of 0.626 and a p-value of 0.000 and Financial planning and controlling had a Correlation of 0.355 and a p-value of 0.000. This means that all the variables had a positive effect on the SMEs' performance. This means that an increase in these variables will cause an increase in the organization's returns. The effect was significant as all the p-values were less than 0.05. This indicates that they are able to predict the changes in the operational performance at any given time.

Impact of financial management practices on performance

In order to examine the impact of financial management practices on performance, multiple regression analysis (table 05) was used in this study.

The decision rule is, if P value is greater than 0.05 accept the null hypothesis and if P



value is less than 0.05 reject null hypothesis. Financial Reporting and Analysis and Working Capital Management significantly impact on Organizational Performance. P values are 0.013 and 0.000 which are less than 0.05. And Accounting Information System and Financial Planning and Control is not significantly impact on organizational performance. Therefore, the significance level is more than 0.05 for Accounting Information System and Financial Planning and Control should not include in the multiple regression equation.

$Y = 2.144 + 0.199 \text{ Financial Reporting and Analysis} + 0.284 \text{ Working Capital Management}$

Hypothesis 1

H 1.1: There is a positive impact of Accounting Information Systems on performances of SMEs.

According to the regression analysis, P value for Accounting Information Systems is 0.285, which is above 0.05. Thus, it is accepted the null hypothesis and concluded that there is a no positive impact of Accounting Information Systems on performances of SMEs in Sri Lanka.

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H 1.2: There is a positive impact of financial reporting and analysis on performances of SMEs.

According to the regression analysis, P value for financial reporting and analysis is 0.013, which is below 0.05. Thus, fails to accept the null hypothesis and concluded that there is a positive impact of financial reporting and analysis on performances of SMEs.

H 1.3: There is a positive impact of Working capital management on performances of SMEs.

According to the regression analysis, P value for Working capital management is 0.000, which is below 0.05. Thus, fails to accept the null hypothesis and concluded that there is a positive impact of Working capital management on performances of SMEs. H 1.4: There is a positive impact of financial planning and control on performances of SMEs.

According to the regression analysis, P value for financial planning and control is 0.428, which is above 0.05. Thus, it is accepted the null hypothesis and concluded that there is no positive impact of financial planning and control on performances of SMEs.

Differences in the Usage of Financial Management Practices

In order to examine the differentiation in the use of financial management practices among small sized enterprises and medium sized enterprises in Batticaloa district, Independent Sample T Test was used.

Hypothesis 2

H 2: There is a significant difference in applying financial management practices among Small sized enterprises and Medium sized enterprises in Sri Lanka.

It was observed that the application of Accounting Information System, Financial reporting and analysis, Working capital management and financial planning and controlling highly applied in medium sized Enterprises ((M=3.82, SE=0.071; M=3.77, SE=0.084; Mean=4.25, SE=0.055; M=2.52, SE=0.140) than small sized Enterprises (M=2.91, SE=0.120; M=2.65, SE=0.132; M=3.36, SE= 0.083; M= 1.32, SE=0.088) and the $t(148) = -6.486, p < 0.05$; $t(148) = -7.195, p < 0.05$; $t(148) = -8.907, p < 0.05$ and $t(148) = -7.255, p > 0.05$ respectively.

Table 4: Correlation Analysis

		Performance	AIS	FRS	WCM	FPC
Performance	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	150				
Accounting Information System	Pearson Correlation	0.606	1			
	Sig. (2-tailed)	0.000				
	N	150	150			
Financial Reporting and Analysis	Pearson Correlation	0.665	0.868	1		
	Sig. (2-tailed)	0.000	0.000			
	N	150	150	150		
Working Capital Management	Pearson Correlation	0.626	0.617	0.723	1	
	Sig. (2-tailed)	0.000	0.000	0.000		
	N	150	150	150	150	
Financial Planning and Control	Pearson Correlation	0.355	0.412	0.487	0.582	1
	Sig. (2-tailed)	0.000	0.000	0.000	0.000	

Table 5: Regression Results

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
	AIS	0.086	0.080	0.128	1.072	0.285	0.247	4.050
	FRA	0.199	0.079	0.342	2.510	0.013	0.189	5.297
	WCM	0.284	0.079	0.333	3.597	0.000	0.407	2.455
	FPC	-0.030	0.038	-0.058	-0.794	0.428	0.652	1.533

a. Dependent Variable: performance

Table 6: Independent Sample T-test

Financial Management Practices	Size	N	Mean	Std. Deviation	Std. Error Mean	df	t	Sig. (2-tailed)
Accounting Information System	Small	67	2.91	0.984	0.120	148	-6.486	0.000
	Medium	83	3.82	0.644	0.071			
Financial	Small	67	2.65	1.078	0.132	148	-	0.000



Reporting and Analysis	Medium	83	3.77	0.765	0.084		7.195	
Working Capital Management	Small	67	3.36	0.682	0.083	148	-	0.000
	Medium	83	4.25	0.500	0.055		8.907	
Financial Planning and Control	Small	67	1.32	0.719	0.088	148	-	0.000
	Medium	83	2.52	1.275	0.140		7.255	

Therefore, it is fair to say that there is a significant difference between small sized Enterprises and medium sized enterprises in applying financial management practices in terms of Accounting Information System, Financial reporting and analysis, Working capital management and financial planning and control. This finding is consistent with previous studies of Karunanada and Jeyamaha, (2011) examines the financial practices among Small & Medium-sized Enterprises in Sri Lanka and its impact of financial practices on business performance amongst SMEs in Sri Lanka. The findings showed that a significant difference in comprehensiveness of financial management practices between small enterprises and medium-sized enterprises in study sample, with these practices being more extensive in medium-sized concerns. And also, the finding is consistent with Yogendrarajah, Kengatharan, & Suganya, (2017) investigated the financial management practices and performance of SMEs in Sri Lanka: evidence from Jaffna District. The findings showed that financial management practices significantly differing in applying by small and medium sized enterprises and all the financial management practices are highly applied by medium sized enterprises than small enterprises. Therefore, hypothesis (H2) is accepted with the results of the study that there is a significant difference in applying financial management practices among Small sized enterprises and Medium sized enterprises.

Challenges Faced by the SMEs to Follow the Financial Management Practices

According to the table 8, 34.7 %, 23.3%, 16.7%, 13.3% and 12% of respondents respectively mention that lack of accounting knowledge, high cost of obtain service from outside accountants, cost and time constraint, lack of guiding rules and fear of legal obligation are the challenges faced by the business to follow the financial management practices. The finding is consistent with the previous study of Zotorvie, (2017) conducted the Financial Accounting Practices of SMEs in Ho Municipality, Ghana. This study finding conclude that the major reasons for the entities failure to maintain proper accounting records was high cost of hiring qualified accountants and lack of knowledge in accounting on the part of some owner-managers [changed]. It shows that most of the business owners have lack of accounting knowledge to follow the financial management practices.

Table 8: Challenges

Challenges	Frequency	Percent
Lack of accounting knowledge	52	34.7
Cost and time constraint	25	16.7
Lack of guiding rules	20	13.3
High cost of obtaining service from outside accountants	35	23.3
Fear of legal obligation	18	12.0
Total	150	100.0



Discussion of Findings

Accounting Information System and Performance of SMEs

The findings of the study revealed that there is no significant positive impact of accounting information system on the financial performance of SMEs. This finding is consistent with previous studies of Uduwaka & Dedunu, (2019) examined the effect of financial management practices on financial performances of SMEs in Sri Lanka. However, the finding of this study is not consistent with the previous study of Belal (2013) investigated the Use of Accounting Information of SMEs in Jordan. They recommended that good accounting practices will improve the effective operations of SMEs. The finding is not consistent due to the poor involvement, interpreting the accounting information and use the computer assisted software for their operation. According to the previous studies there are insignificant accounting practices in other part of Sri Lanka also. The positive insignificant regression results may indicate that SMEs need to have high level of practice of accounting information systems in order to have positive and significant impact towards performance of SMEs. It emphasizes that the government may want to provide the suitable trainings to get the knowledge of accounting practices.

Financial Reporting Analysis and Performance of SMEs

The findings revealed that improvement in financial reporting leads more effective and efficient management of SMEs and significantly improve their prospects. The positive significant regression results indicate that SMEs have high level of practice of Financial Reporting and Analysis have positive and significant impact on performance of SMEs. This finding is consistent with previous studies of Turyahebwa, et.al, (2013) which investigated financial management practices and business performance of SMEs in western Uganda. It indicates that efficient

financial reporting and analysis is highly associated with high business performance. And also the previous study of McMahon and Adelaide (1995) examine the impact of financial reporting practices upon business growth and performance in manufacturing SMEs in Australia. Even though there is a significant impact on the performance, there is less involvement by SME owners to prepare the financial statements. Most of the SME owners depend on the outside accountants and others to prepare their financial statements. And due to the poor knowledge in accounting most of the SME owners does not consider the ratios and use the financial statement for their decision making. This could lead the businesses to fail. Therefore, the SME owners need to concentrate on their financial reporting to sustain their success. The significant findings of this variable indicate the SME owners should concentrate more on financial reporting and analysis and the level of practices of each dimension which are coming under this variable.

Working Capital Management and Performance of SMEs

According to the multiple regression, hypothesis of this study shows that there is a significant positive (95% of confidence interval) impact of Working capital management on performances of SMEs. These findings consistent with the findings of Tharindi & Rathnayaka, (2016) who investigated Financial Management Practices and Performance of SMEs in Sri Lanka. The findings revealed that there is a positive relationship between working capital management and financial performance of SMEs in Sri Lanka. Further, this study's finding is consistent with previous studies of Nyamao, Lumumba, Odondo & Otieno (2012) who examined the effects of working capital management practices on the financial performance of small-scale enterprises in Kenya. The study found that working capital management practices were low amongst small-scale enterprises as majority of them had not



adopted formal working capital management routines. And the study revealed that working capital management influences the financial performance of small scale enterprise. Thuryahebwa et al. (2013) found a consecutive relationship between working capital management and financial performance. Findings also state that positive attitudes regarding financial management practices should be developed in the minds of owner managers of SMEs in order to enhance the financial performance of the SMEs. The finding is consistent with previous studies due the high concern in cash management, receivables and inventory management. The positive significant regression results indicate that SMEs have high level of practice of working capital management have positive and significant impact on performance of SMEs. Even though there is a significant impact on the performance, there is less involvement by SME owners to prepare the cash budget and use of proper inventory management practices. To improve this area, the responsible authorities need to conduct seminars to SME owners regarding maintaining cash budget and inventory management practices in their businesses.

Financial Planning and Control and Performance of SMEs

This study found that there is no positive impact of financial planning and control on performances of SMEs. This finding is consistent with previous studies of Uduwaka & Dedunu, (2019) who found that the effect of financial management practices on financial performances of SMEs in Sri Lanka. The findings are consistent with these studies due to low adoption of preparation, interpretation and use of financial budget in their business. The SME owners do not aware about the financial budget usage in the businesses. Contrarily to these findings, Musando's (2013) study based on SMEs in Nairobi revealed that financial planning has no significant impact on performance. The negative insignificant regression results indicate the owners' non-

awareness about the one of the very important components of financial management, financial planning and control. Further, the negative insignificant regression results may indicate that SMEs need to have high level of practice of Financial planning and control in order to have positive and significant impact towards performance of SMEs. To improve this area, government agencies need to help the SME owners through the trainings or seminars.

Financial management practices of SMEs from Legitimacy theory perspectives

Legitimacy theory emphasizes the importance of societal acceptance in ensuring a company's existence and survival (Ghazali, 2007). The authors argue that an underlying assumption of legitimacy theory is the belief that a SMEs actions can have an impact on the surrounding environment in which it operates, and in case SMEs activities are perceived to have detrimental or negative effects on the business itself, environment and the society. In this instance, firms legitimate their activities through various means, including communication with relevant stakeholders (Ashforth and Gibbs, 1990), and specifically by applying good management practices such as financial management practices.

The results indicate that 93.3 % of the sampled SMEs apply financial management practices (FMPs) due to pay taxes on time and other legislative reasons. These could be categorised as broader societal and legislative purposes. 6.7 % of the sampled SMEs indicated that they apply FMPs due to profit maximization reasons which could be categorised as mere satisfaction of owners' expectations.

The findings indicate that Accounting information systems and financial reporting and analysis have been adopted the moderate level, working capital management at a high level and financial



planning and control at a low level. The authors argue that most of the above indicators adopted at a moderate or higher level due to the fact that the sampled SMEs continually seek to ensure that they operate within the bounds and norms of their respective societies. The adoption of financial management practices is expected to be a must to ensure survival and growth of an organization. By the adoption of these practices, the society at large expect a fair return to the society (Deegan, 2001) by way of employment, use of domestic raw materials, payment of taxes on time, goods and services at reasonable price and contribution to the economic development.

The SME owners perceive that all the independent variables; Accounting Information Systems, Financial Reporting and Analysis, Working Capital Management and Financial Planning and Control significantly relate to their performance. The possible reasons for this could be the fulfilment of the 'social contract' between the SME and the society at large. Legitimacy Theory emphasizes that the organization (SME) must appear to consider the rights of the public at large, not merely those of its (SME's) investors.

The results indicate that Financial reporting and analysis and Working capital management is significantly impact on SMEs Performance. The SMEs owners perceive that Financial reporting and analysis and Working capital management are the most important elements of financial management which positively impact on their performance. The identification of the above elements is important to comply with the broader 'social contract'.

The existence of an organisation is threatened if it is regarded as violating the implied social contract. This is usually believed to take place whenever the society members are not satisfied with the behaviour of the concerned company (Milne and Patten, 2002). Failure to comply with society expectations leads to revocation of the contract (Deegan and Rankin, 1996).

The sampled SMEs seems to be practising financial management practices in order to comply with the said 'social contract'.

It is found that there is a significant difference between small sized enterprises and medium sized enterprises in applying financial management practices. This could be due to the reason of the size of the 'social contract' depends on the size of the SME. Medium sized enterprises may have a greater social contract with large number of stakeholders than the small sized enterprises.

Conclusions

Findings conclude that Accounting information system and financial reporting and analysis have been adopted under the financial management practices by the SMEs at the moderate level. Working capital management have been adopted under the financial management practices by the SMEs at the high level and financial planning and control have been adopted at the low level.

In the investigation of impact of financial management practices on the performance, it was concluded that Financial Reporting and Analysis and Working Capital Management is significantly impact on Organizational Performance. Accounting Information System and Financial Planning and Control is not significantly impact on SMEs performance. Further, the study concluded that there is a significant difference between small sized Enterprises and medium sized enterprises in applying financial management practices in terms of Accounting Information System, Financial reporting and analysis, Working capital management and financial planning and control. Finally, the study concluded that the major challenges faced by the SMEs to adopt the financial management practices are preparation of a complete set of financial



statements are high cost of hiring qualified accountants and lack of knowledge in accounting of the owner-managers.

Legitimacy as defined by Lindblom (1994: 2) is “a condition or a status which exists when an entity's value system is congruent with the value system of the larger social system of which the entity is a part. When a disparity, actual or potential, exists between the two value systems, there is a threat to the entity's legitimacy”. The argument underlying legitimacy theory is that organisations can only survive if they are operating within the framework of the society's norms and values. To maintain their legitimacy, SMEs practice important financial management practices to legitimise their activities, that is, to obtain the society's impression of being socially responsible. Accordingly, application financial management practices aim to legitimise company behaviour by ensuring the survival and growth to influence the society's perceptions about the SME.

Recommendations and Implications

The study recommends that the government and other regulatory bodies to create favourable policies on the adoption of financial management practices for the SMEs. This will ensure that there is effectiveness, efficiency as well as consistency in the use and adoption of financial management practices in the SMEs. And provide incentives which encourage more SMEs to adopt the financial management practices. Further, it recommends to introducing accounting standard for SMEs which are easily understand by the SME owners. The government could introduce an annual entrepreneur of the year award for best financial management practicing SME

which will encourage small businesses amongst themselves and will result in frequent use of financial management practices.

Further, the study recommends that the government should introduce the entrepreneurship and basic accounting subject in the ordinary level education. It helps to get knowledge regarding the basic accounting knowledge. The government, government agencies or NGOs should conduct the training programme for the SME owners to get the knowledge reading the accounting practices. Government should operate the qualified accountant team to serve the SMEs at a low cost or should introduce a center (may be a call center) to help them when ever needed. And Government should mitigate the legislation to the SME owners regarding their financial operations.

Future Research

The study makes several suggestions for future researchers on areas which emerged during the study and require further research. This study collected data from 150 SME owners in Batticaloa district. Therefore, the study thus recommends further studies to be conducted in other districts as well as in the whole island so as to enable comparison of the findings of the study. The study uses the accounting information system, financial reporting and analysis, working capital management and financial planning and control as a financial management practices of the business. However, the future study can be used other financial management practices such as fixed asset management, capital budgeting, financial structure management etc.



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