AN ASSESSMENT ON FINANCIAL MANAGEMENT PRACTICES OF SMALL BUSINESSES: CASE STUDY OF SOKORU DISTRICT

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JUNE, 2014 
JIMMA, ETHIOPIA
Declaration

I hereby declare that this thesis is my own work towards the executive Masters of Accounting and Finance and that, to the best of my knowledge, it contains no material previously published by another person nor material which has been accepted for the award of any other degree of the University, except where due acknowledgement has been made in the text.

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Name of Institution ......................................................................................
Date of submission ....................................................................................

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Assessment of Financial Management Practices of Small Businesses: Case Study of Sokoru District

By: - SOLOMON TERFASA

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Abstract

Small firms have been identified as an importation contributor to the economy. In Ethiopia economy, this sector contributes to the national objective of creating employment opportunities, generating income, and providing a source of livelihood for low income households. However, the small firms have not been able to contribute substantially as needed to the economic development mainly because of inadequate of financial management practices. Given that the issues of financial management is one of the key aspects of the well being and survival of a business enterprise in Sokoru District (Sokoru Town), as to those specific variables namely, working capital management, financing, investment, financial reporting, planning, analysis and control, and accounting information systems. To achieve the stated objectives of the study the primary data were obtained from the targeted groups of owners’ small firms and trade and industry office of Sokoru District. Both stratified and simple random sampling methods were used to select sample in the study. The study found that the financial management practices of small firms are very weak – especially in the areas of financial planning, analysis, and control working capital management, and investment decision. The study also recommended that it advisable that the owners of small avail themselves with various training programs; better to evaluate the validity of their investment before starting operations; better to engaged in financial planning, analysis, and control in order to compare their financial plan with performances; and maintain professional accountants so as maintain complete accounting records.
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<th>Description</th>
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<tr>
<td>UNDP</td>
<td>United Nation Development Program</td>
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<tr>
<td>ILO</td>
<td>International Labor Organization</td>
</tr>
<tr>
<td>SMEs</td>
<td>Small and Medium Enterprises</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
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<tr>
<td>MoFED</td>
<td>Ministry of Finance and Economic Development</td>
</tr>
<tr>
<td>IFC</td>
<td>International Finance Corporation</td>
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<td>SEDA</td>
<td>Small Enterprise Development Agency</td>
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CHAPTER ONE
INTRODUCTION

1.1 Background of the Study

Small businesses have no specific or generally accepted definition (Hashim, 2005 and Fetene, 2010). In fact, it is impossible, because, the sector is varied and flexible that resists any narrow categorization. In this regard, researchers and policy makers are looking for an objective definition of small business, have used a variety of criteria such as total capital, relative size within industry, number of employees, value of products, annual turnover and so on (Agyei-Mensah, 2010).

The definitions given to small businesses vary from country to country and also indicate different things to different people, even within the same country. However, the most common definitional basis used is employment, but, there is a variation in defining the upper and lower size limit of small business firms (Ayyagari, Beck and Demirguc-Kunt, 2007). Definitions with multiple criteria. For instance, South Korea defines small business on the basis of capital or assets; while Canada defines this term on the basis of number of employees and gross sales or taxable income. This lack of consistent definition has eventually led to be confusion and failure to distinguish between one segment and another and has significant implications on the structure of interventions and promotional support that could be provided to the segment. Nevertheless, for the purpose of this study, the researcher uses number of employees based on the working definition by ILO and UNDP for micro, small, medium and large business is used. This working definition indicates that; employing less than 5 employees including the owner is a micro enterprise; employing 5 to 20 employees is a small enterprise; employing 21 to 99 employees is a medium enterprise; and employing above 99 employees is a large enterprise (UNDP, 2001).

In Ethiopia, there is no clear definition of businesses as micro, small and large however, only paid up capital is used for the categorization of business as micro, small, and large. In this case,
exceeding birr 500,000 excluding high tech constancy firms or manufacturing enterprises. However, there is no categorization of business above small scale enterprises as medium and large enterprises in the country (Tafa, 2011).

Badnhoorst et al., (2010) revealed that, although different countries define small businesses differently, it is accepted practice to make use of quantitative and qualitative criteria when attempting to define small businesses. From this point of view, a small business is defined as one which possesses at least the following qualitative characteristics adopted by the Bolton Committee, (1971).

- A small firm is one that has a relatively small share of the market, and is unable to influence the price or quantity of goods or service.
- It is managed by its owner and not through the medium of a formal management structure.
- It is also independent in the sense that it does not form part of a larger enterprise and that the owner-managers should be free from outside control in making their principal decisions.

McMahon et al., (1993) identified the quantitative characteristic of small and medium firms using number of employees, sales revenue or turnover, total assets, and net worth. In this regard, number of employees is the most widely used measure of size in quantitative definitions of small enterprise around the world, although the turnover and the total assets also find significant use.

Until the early 1960s, many economists viewed the continued existence of small-scale industries in less developed countries as justified by scarcity of capital and administrative experience. It was often argued that with economic growth the small traditional type of enterprise would in one sector after another be outdated by modern forms of large-scale production.

In the mid-1960s, a new approach to small to medium-scale enterprises development began to emerge due to a number of factors. First, there was growing concern over low employment elasticity of modern large-scale production. It was claimed that even with more optimal policies,
this form of industrial organization was unable to absorb a significant proportion of the rapidly expanding labor force (Chenery et al., 1974 and, ILO, 1973). Second, there was wide-spread recognition that the benefits of economic growth were not being fairly distributed, and that the use of large-scale, capital-intensive techniques was partly to blame (Chenery et al., 1974). Third, empirical evidence showed that the causes of poverty were not confined to unemployment, and that most of the poor were employed in a large variety of small-scale, low-productivity activities. Thus, it was thought that, one way to alleviate poverty could be to increase the productivity of those engaged in small-scale production (Aftab and Rahim, 1989). This suggested a new role for small industries, or what has come to be labeled "the urban informal sector". Small labor-intensive industries were seen not only to increase employment, but also to increase the living standards of the poor. They were also thought to be capable of providing a new dynamic of economic growth. The new objective was not just to stop the retreat, but, to promote the small-scale sector (Aftab and Rahim, 1989). This change in approach was accompanied by a shift of focus towards a rurally orientated small-holder industrialization strategy (UNDP, 1974).

Small business literature supports the argument that the small business sector contributes substantially to economic growth, job creation, fair distribution of income, and to the alleviation of poverty (Broembsen, 2003:4). For instance, in Europe, 99.8% of private businesses are small businesses and they generate half of Europe’s turnover and employ about 53% of the workforce (Reijonen and Komppula, 2007:689).

According to Cook and Nixson, (2000), Hashim, (2005), and Fetene, (2010) small business development has become increasingly important in recent years in both developed and developing countries. So, small businesses have been identified as an important contributor to the economy in terms of economic output and employment opportunities. In Ethiopia, the small business sectors have been neglected for a long. However, following the country’s shift to a market economy, the government and other stakeholders have shown interest in the area. This shift to a market led private sector, which would then foster the development of small businesses in Ethiopia as they constitute the majority of the sector (Fetene, 2010).
Basically, there are many factors contributed to the failure of small business firms. These factors can also be recognized as internal and external factors. Though, the external factors are not the concern of this study, while the internal factors that affect the small firms are such as managerial skills, workforce, accounting systems, and financial management practices and etc. Nevertheless, given this fact, 'poor' financial management practices are one basic internal factor that affects the performances of small businesses among others (Agyei-Mensah, 2011).

Financial management is also critical, especially in relation to working capital and over-trading, due to the lack of medium and long-term finance available to small businesses and the reliance on short term debt funding (McMahon and Holmes, 1991, Dodge et al., 1994). So, without addressing the problems concerning with financial management practices of small firms, their business performance cannot be literary achieved. Given that, financial management is one of the key aspects for the well being and survival of a business; the researcher believes that, it is important that this topic is expected to explore the financial management practices of small business sector.

This study was aimed to assess the financial management practices of small business enterprises of Sokoru District (Sokoru Town), as to those specific areas of financial management such as, working capital management, financing, investment, financial reporting, financial planning, analysis, and control, and accounting information systems.
1.2 Statement of the problem

Although, small business literature supports the argument that the small business sector contributes substantially to economic growth, job creation, and to the alleviation of poverty still they fail. In fact, there appears to be a number of enabling conditions that must be present before the small business sector can contribute to the economic development of a country. For instance, (Chittenden et al., 1999, and Broembsen, 2003) revealed that, small scale enterprises frequently fail mainly because of 'poor' financial management practices. Gaskill and Van Auken, (1993) argued that, the most internal problems known by small firms in US relate to insufficient capital, cash flow management and inventory control. Hashim and Wafa, (2002) suggested that while the role of small firms contributing to the economy is considerable, many small firms are faced with various management problems. For instance, financial management is one among the others such as human resource management, marketing management, operations management, and strategic management.

Agyei-Mensah, (2011) also adds that, careless financial management practices are the major cause of collapse for business enterprises. Studies done in the UK and the US have shown that weak financial management particularly, poor working capital management and inadequate long-term financing were primary cause of failure among small business (Atrill, 2001). Further, the findings of the studies by Broom and Lengenecker, (1975), Haswell and Holmes, (1989), Bates and Nucci, (1989), and Watson and Everett, (1996) have shown that business failures were more prevalent among small businesses than larger firms. Given that, the possibility of business failure due to lack of sound financial management practices became a serious issues that seeks special attentions.

According to IFC, (2006) in Sub-Saharan Africa, 80% of firms are small. Hence, it is observably not simply the proliferation of small businesses that makes economic growth. In this regards, Spencer and Gomez, (2004) confirmed a negative relationship between per capita GDP and the percentage of small firms in a country. It would appear that the proliferation of small business is a characteristic of less developed countries that lack the economies of scale provided by a considerable large firm sector. In case of Ethiopia, the issues of small firms are serious. For instance, according to MoFED, as cited by Fetene, (2010), the contribution of the small
businesses sectors to the country’s GDP is on average 1.7% during the past decade. Its contribution is still lower than large and large and medium enterprise in which their average growth rate is 5.6% and 7% respectively. This implies that, the contribution of small business sectors contributing to the economy is relatively insignificant.

Evidences shown that, the issues of financial management were recognized in Ethiopia since the beginning of 1960s, when Imperial Haile Selassie introduced commercial code. So, these issues became the pressing problems of small business enterprises. The fact that, most business enterprises do not appointed professional accountants; cope up with technological knowhow; have financial planning, and have proper working capital management the growth and survival of small firms significantly affected (Derese and Prabhakara, 2012). This implies that, in Ethiopia the issues of financial management in small business enterprises are the key areas that seek special consideration and call professional for further investigations. Therefore, in order to achieve the objectives for which small business enterprises established these problems should be addressed. So, that’s why the researcher was interested on this study.
1.3 Research Questions

The research questions addressed in the study were the following.

- What are the performances of owners of small firms in financial management practices?
- What are factors that inhibit financial management practices of small firms?
1.4 Objectives of the Study

The objectives of the study can be sub-divided into general and specific objectives. It can be presented as follows.

1.4.1 General objective

The overall objective of the study was to assess the financial management practices of small business enterprises in Sokoru District (Sokoru Town).

1.4.2 Specific Objectives

The specific objectives of the study are:

- To explore the performances of owners’ of small firms in financial management practices.
- To identify factors that inhabits the application of financial management of small firms.
- To offer recommendations to improve the small firms in the area of financial management practices.
1.5 Scope of the Study

The scope of the study was recognized as Subject or Conceptual and Geographical scopes.

1.5.1 Subject (Conceptual) Scope

The study was limited to six variables of financial management of small firms namely working capital management, financing, investment, financial reporting, financial planning, analysis and control, and accounting information systems.

1.5.2 Geographical Scope

This research is focused on financial management practices of sampled small business firms of Sokoru District, specifically to Sokoru Town. Nevertheless, the researcher wishes if he conducted a wide-ranging study on the problem areas however, due to certain constraints such as finance, time and other resources the study was confined to Sokoru District (Sokoru Town).
1.6 Significance of the Study

The followings are the potential significances of the study.

- It adds to the existing body of knowledge and literature on the financial management practices of small firms.
- It will serve as a supplementary material for future researches.
- It helps owner-mangers' of small businesses, and other stakeholders in appropriate decision makings.
1.7 Organization of the Study

The study consists of five chapters. The first chapter presents the introduction and background of the study; statement of the problems; research question; objectives of the study; scope of the study; significant of the study; organization of the study, and ends up with limitations of the study. The second chapter demonstrates the reviews of related literature, which constitutes international and domestic empirical evidences and theoretical justification too. The methodology of the study is also the subject of chapter three. It describes the types and sources of data, population, sample and sampling procedures, methods of data processing, analysis, and interpretation of the study. The fourth chapter shows the discussion and analysis parts. Lastly, chapter five presents the Findings, conclusions, and the recommendations sections of the study.
1.8 Limitation of the study

Basically, research is a big task it requires sufficient time, finance, research knowledge, and different material supports so as to arrive at credible conclusions. So, the followings were main limitations of the study.

- Limitation of secondary sources of data relevant to the issues under study. For instance there were no secondary data in Sokoru District trade and industry office that support the issues of financial management of small firms.
- Un-openness's of some respondents to react for the questionnaires forwarded to them. That is some respondent were not willing to react to the questionnaires supposing that the research is conducted for some other purposes such as tax issues.
- The geographical scope also another limiting factor because, the study was conducted in Sokoru District, Sokoru town, and general conclusion was made.
CHAPTER TWO

2. REVIEWS OF RELATED LITERATURES

This section presents a brief review of the existing theoretical and empirical related literatures of financial management practices of small businesses. After having reviewed, the literature gap was identified, filled, and proposed for further study.

2.1 Theoretical and Empirical Literature Reviews

2.1.1 Financial Management

Financial management is defined with different authors in different ways. However, those definitions are not different in meanings in the sense that, all of them rotate around the effective funds management in the businesses. For instance, different authors described the definition of financial management as follows.

- According to Solomon, "financial management is concerned with the efficient use of an important economic resource namely, capital funds".
- According to S.C. Kuchal, "financial Management deals with procurement of funds and their effective utilization in the business" (the most popular and acceptable definition of financial management).
- According to Weston and Brigham, "financial management is an area of financial decision-making, harmonizing individual motives and enterprise goals".

Financial management is an integral part of overall management. It is concerned with the duties of the financial managers in the business firm. As Meredith, (1986) suggested that, financial management is one of several functional areas of management but, it is the central to the success of any business enterprises. This definition emphasizes the central role and position of financial management in relation to the other specific areas of business management.
According to (McMahon et al., 1993), financial management is concerned with raising the funds required to finance the enterprise’s assets and activities, the allocation of these scarce funds between competing uses, and ensuring that the funds are used effectively and efficiently so as to achieve the enterprise’s objectives. But, according to Meredith, (1986) financial management is concerned with all areas of management, which involve finance not only the sources, and uses of finance in the enterprises but also the financial implications of investment, production, marketing or personnel decisions, and the total performance of the enterprise.

English, (1990), also argues financial management is concerned with what is going to happen in the future. Its purpose is to look for ways to maximize the effectiveness of financial resources. Dayananda et al., (2002:1) suggested that, the financial manager is engaged in two primary tasks, namely financing and investment decision-making. Nieman et al., (2006) adds that, financial management is responsible for acquiring the necessary financial resources to ensure the most beneficial results over both the short and the long term and making sure that the business makes the best use of its financial resources. So, from the above definitions one can realize that Financial Management is mainly concerned with the effective funds management in the businesses.

2.1.2 Modern Financial Management Theories on Small Firms

Modern Financial Management Theories on small firms are adopted with different authors in different periods. For instance, the followings are few among others which are formulated on principles considered as a set of fundamental tents that form the basis for financial theory and decision making in finance.

2.1.2.1 Agency Theory

Agency theory deals with the people who own the business enterprises and all others who have interest in it, for instance, managers, creditors, family member, and employees. The agency theory postulate that, the day to day operations of a business enterprise is carried out by managers-agents who have been engaged by the owner’s of the business as principals who are also know as shareholders. The theory is on the notion of the principle of two sided transaction which holds that any financial transaction involve two parties, both acting in their own best

2.1.2.2 Signaling Theory
Signaling theory rests on the transfer and interpretation of information at hand about a business enterprise to the capital market, and the impounding of the resulting perceptions into the terms on which finance is made available to the enterprise. In other words, flows of fund between an enterprise and the capital market are dependent on the flows of information between them (Emery et al., 1991). The emerging evidence on the relevance of signaling theory to small enterprise financial management is mixed. Until recently, there has been no substantial and reliable empirical evidence that signaling theory accurately represents particular situations in SMEs financial management, or that it adds insights that are not provided by modern theory (Emery et al., 1991). Emery et al., (1991) further suggested that, Signaling theory is now considered to be more insightful for some aspects of small enterprises financial management than others.

2.1.2.3 Peaking Order Theory
This is another financial theory, which is to be considered in relation to SMEs, financial management. It is a finance theory which suggests that firms finance their needs in a hierarchical order, first by using internally available funds, followed by debt and finally, external equity (Myers, 1984). A research by Norton, (1991) found out 75% of small enterprise used seemed to make financial structure decision within a hierarchical or pecking order theory. Holmes et al., (1991) also adds that, Pecking Order Theory is consistent with small business sectors because, owner-managers do not want to dilute their ownership owner managed business usually prefer retained profits because they want to maintain the control of assets and business operations.

2.1.2.4 Access to Capital
The 1971, Bolton report on small firms outlined issues underlying the concept of ‘finance gap’ which has two components namely Knowledge gap and Supply gap. The Knowledge gap refers to debt is restricted due to lack of awareness of appropriate sources advantages and disadvantages of finance whereas, the Supply gap refers to the unavailability of funds or cost of
debt to small enterprise accepted the cost of debt for large enterprise. That is, there are a set of challenges which face a small company. Small firms are hit harder by taxation, face higher investigation costs for loans, are generally less well informed of sources of finance and are less able to satisfy loan requirements. Small firms have limited access to the capital and money markets and therefore, suffer from chronic under capitalization. As a result, they are likely to have excessive resource to expressive funds which act as a brake on their growth and survival.

2.1.2.5 Equity Funds

Equity is also known as owner’s equity, capital, or net worth. Costend et al., (1990) suggests that, large firms will use greater levels of debt financing than small firms. This implies that, large firms will rely relatively less on equity financing than do small firms. According to Peaking Order Theory, the small enterprises have two problems to equity funding (Mc Mahon et al., 1993). First, small enterprises usually don’t have the option of issuing additional equity to the public. Second, owner-managers are strongly averse to any dilution of their ownership interest and control.

2.1.3 Scopes of Financial Management

Financial management is one of the important parts of overall management, which is directly related with various functional departments like personnel, marketing and production. Financial management covers wide area with multi-dimensional approaches. For instance, Paramasivan C., and Subramanian T., (2009:4) suggested the scope of financial management as follows.

2.1.3.1 Financial Management and Accounting

In the early periods, both financial management and accounting are treated as the same discipline and then it has been merged as Management Accounting because this part is very much helpful to finance manager to take decisions. But now a day’s financial management and accounting discipline are separate and interrelated.

2.1.3.2 Financial Management and Economics

Economic concepts like micro and macroeconomics are directly applied with the financial management approaches. Investment decisions, micro and macro environmental factors are
closely associated with the functions of financial manager. Financial management also uses the economic equations like money value discount factor, economic order quantity etc. Financial economics is one of the emerging area, which provides immense opportunities to finance, and economical areas.

2.1.3.3 Financial Management and Production Management
Production management is the operational part of the business concern, which helps to insist the money into profit. Profit of the concern depends upon the production performance. Production performance needs finance, because production department requires raw material, machinery, wages, operating expenses etc. These expenditures are decided and estimated by the financial department and the finance manager allocates the appropriate finance to production department. The financial manager must be aware of the operational process and finance required for each process of production activities.

2.1.3.4 Financial Management and Marketing
Finished goods are sold in the market with innovative and modern approaches. So, the marketing department needs finance to meet their requirements. The financial manager or finance department is responsible to allocate the adequate finance to the marketing department. Hence, marketing and financial management are interrelated and depends on each other.

2.1.3.5 Financial Management and Human Resource
Financial management is also related with human resource department, which provides manpower to all the functional areas of the management. Financial manager should carefully evaluate the requirement of manpower to each department and allocate the finance to the human resource department as wages, salary, remuneration, commission, bonus, pension and other monetary benefits to the human resource department. Hence, financial management is directly related with human resource management.

2.1.4 Objectives of Financial Management
Paramasivan C., and Subramanian T., (2009:5) suggested that, the primary objectives of most kinds of economic activities are profit motive. As Firer et al., (2004) revealed that, the goal of
financial management is to maximize the wealth of the owners of the firm. According to (Brigham and Daves, 2004:6), the fundamental assumption underlying the theory of business management is that managers have one basic overriding goal, namely to create value for shareholders or to maximize the value of the firm.

Dayananda et al., (2002:1), also suggested even though various objectives or goals are possible in the business, the most widely accepted objective for the business is to maximize the value of the business to its owners. Maximization of shareholders’ wealth is a broader goal than maximizing profit as it is linked with return, risk, growth, stability, control and at same time most probably satisfying shareholders.

McMahon and Stanger, (1995:21), questioned that, whether maximizing the value of the firm to its owners is a valid and useful objective for small business firms. They assert that entrepreneurs may establish a business as an alternative to unemployment or as a way to avoid employment dullness. In each case, the primary objective of the entrepreneur may be to maintain the viability of the business, rather than to maximize the value. Danielson and Jonathan, (2006:3-4) further argued that, shareholders’ wealth maximization may not be the objective of every small business.

Spence and Rutherford, (2000:131-132), suggested that, the main objective of owner-managers of the business is to maximize profit. Profit is the motivational factor to start and keep the business and to always overcome other social motivation. These authors concluded that, in a small business environment, the financial goal should be to strive for profit maximization. As it was revealed by Osteryoung et al., (1997), it is important to note that, firms have stated or unstated objectives. Corporate finance theory assumes that, the objective of the firm is to maximize shareholder’s wealth. This is, however, usually not the case with small business who often does not participate in the capital markets. Small business enterprises often exhibit differences in their objectives for running their businesses well away from the traditional shareholder wealth maximization concept. The objectives of small businesses consist of just having a job, enjoying a particular way of life linked with getting involved in a particular business, providing income to the owner-manager; and growing the business in terms of earnings through sales.
2.1.5 Financial Management Practices and Firms Performances

For the purpose of this study, financial management practices are defined and notable as the practices carried out by owner-managers of small firms in those specific areas of financial management such as working capital management, financing, investing, financial planning, analysis, and control, financial reporting, and accounting information systems.

Evidences shown that, sound financial management practices have positive effects on firm’s performances. According to Azhar et al., (2010), Maseko and Manyani, (2011), literature on financial management of small firms identifies the components of financial management practices are crucial to the performance of small firms as financial planning and control, financial reporting and analysis, financing, capital budgeting, working capital management, and accounting information system.

Belgium and Deloof, (2003) suggested that, the way working capital is managed will have a significant impact on the profitability of a firm. This implies that, well working capital management will have positive effects on the firms’ performances. Furthermore, Gill et al, (2010) and Agyei-Mensah, (2011) argued that, there exists a direct relationship between working capital management and firm liquidity. According to Maseko and Manyani, (2011), accounting information systems provide a source of information to owners and managers of small businesses operating in any business for use in the measurement of financial performance. So, it is important that, the accounting practices of small firms provided complete and relevant financial information necessary to get better economic decisions made by the owner’s of the businesses.

As Brigham and Ehrhardt, (2008) also find out that, capital budgeting decision is fundamental to a firm’s financial well being and is among the most important decisions that owners or managers of a firm must make. Horngreen, Datar and Foster, (2006) revealed that, financial plan or budgets will have a positive effect on firm’s profitability. Derese and D. Prabhakara, (2012) on their part identified that, the efficiency of financial management practices and characteristics can bring about higher profitability for the businesses. So, Sound financial management is essential tool for growth and survival of business enterprises.
2.1.6 Specific Areas of Financial Management

Most authors and researchers approach to specific areas of financial management in different ways depending upon their views. Barrow, (1988) emphasizes a practical rather than theoretical outlook of specific areas of financial management. That is, instead of identifying specific areas of financial management, he listed the tools of financial analysis, including business controls; measure of profitability; control of working capital; control of fixed assets, cost; volume; pricing and profit decisions, and business plans and budgets.

McMahon (1995) examines specific areas of financial management including all areas that relate to items on the balance sheet of the business. Meredith (1986) emphasizes information systems as a base for financial management including financial management records and reports. Kieu, (2004) as cited by Derese and Prabhakara, (2012), tried to identify the main areas of financial management including planning, financial leverage, investment decision-making, working capital management, and sources of financing. Nevertheless, for the purpose of this study the following six specific areas of financial management were considered.

- Financial planning, analysis, and control – deals with financial objectives and targets, financial budgeting and control, and analysis and interpretation of financial performances.
- Financial reporting – concerning with the nature, frequency and purpose of financial reporting.
- Working capital management – regarding with a firm’s investment in short-term assets, cash, accounts receivables and inventories.
- Accounting information Systems – is a system that collects, records, stores and processes data to produce information for decision makers. It uses advances technology or a simple paper and pencil system or it can be something in between.
- Capital Budgeting (Investing) – concerned with the allocation of the firm’s source financial resources among the available opportunities.
- Financing (Capital Structure) – refers to the relative amount of long-term debt and equity.
2.1.6.1 Short-term Financial Planning

Firms must plan for both the short-term and the long-term. Short-term planning rarely looks ahead further than the next 12 months. It is largely the process of making sure the firm has enough cash to pay its bills and that short-term borrowing and lending are arranged to the best advantage (Brealey et. al, 2001:92).

Given the financial planning is very important for every business, large or small there must be a financial plan before each term’s work. Even though, planning can be approached differently by small business as compared to large ones the fact is that, planning must be exercised. According to Walker and Petty, (2001:38) in a vibrant small business, the planning function is given very little consideration while it may be the most important function that the managers have to perform.

Gitman, (2010:108) indicated that the key aspects of short-term financial planning are profit planning and cash planning. Profit planning is done by compiling pro forma financial statements such as income statements and balance sheets. Cash planning is also done by generating a cash budget. The financial planning process can be approached in different ways; however, the basic components include forecasting, developing a course of action, and generating projected financial statements associated with a given set of forecast and actions (Walker and Petty, 2001:58).

2.1.6.1.1 Financial Planning Models

Financial planners often use a financial planning model to help them explore the consequences of alternative financial strategies. Financial planning models support the financial planning process by making it easier and cheaper to construct forecast financial statements. The models automate an important part of planning that would otherwise be boring, time-consuming, and labor-intensive (Brealey et. al, 2001:96).

2.1.6.1.2 Components of a Financial Planning Model

A completed financial plan for a large company is a substantial document. A smaller corporation’s plan would have the same elements but less detail. For the smallest, youngest businesses, financial plans may be entirely in the financial managers’ heads. The basic elements
of the plans will be similar, however, for firms of any size (Brealey et. al. 2001:87). Further, Brealey et. al. 2001:96, summarized components of financial plans as inputs, the planning model, and outputs. Details are shown in the following diagram.

Fig 2.1 The components of a financial plan

- **Inputs** - consist of the firm’s current financial statements and its forecasts about the future. Usually, the principal forecast is the likely growth in sales, since many of the other variables such as labor requirements and inventory levels are tied to sales.

- **The Planning Model** - this model calculates the implications of the manager’s forecasts for profits, new investment, and financing. The model consists of equations relating output variables to forecasts. For instance, the equations can show how a change in sales is likely to affect costs, working capital, fixed assets, and financing requirements.

- **Outputs** - consist of financial statements such as income statements, balance sheets, and statements describing sources and uses of cash. These statements are called pro forma’s, which means that they are forecasts based on the inputs and the assumptions built into the plan. Usually the output of financial models also includes many financial ratios. These ratios indicate whether the firm will be financially fit and healthy at the end of the planning period.

**2.1.6.2 Financial Statement Analysis**

According to Beaumont-Smith, (2007) financial statement analysis deals with the evaluation and interpretation of financial statements. The major financial statements are income statement, balance sheet, and statement of cash flows. The analysis of financial statements provides a quick means of assessing the financial health of a business and helps managers to make informed
financial decisions. For instance, the analysis of financial statements may help to improve revenue, minimize costs, and improve cash flows (Fabozzi and Peterson, 2002:4–5).

Gitman, (2010:45–54) states that the financial statements analysis is of interest to shareholders, creditors and the business’ owner-manager’s who are interested in the firm’s current and future level of risk and returns which affects the business’ value. With the analysis, the interested parties are able to determine whether the business is profitable and the efficiency with which management is using the firm’s assets to generate sales. The financial statements analysis can also assist to determine the ability of the business to satisfy both its short-term and long-term obligations.

2.1.6.2.1 Tools of Financial statement Analysis

There are various tools used to evaluate the significance of financial statement. For instance, Weygandt et. al, (2001 : 651) summarized the three commonly used tools of financial statement analysis as horizontal analysis (trend analysis), vertical analysis (common-size analysis), and ratio analysis.

Beaumont-Smith, (2007:29) also described that; financial statements are analyzed by ratios such as liquidity ratios, solvency ratios, and profitability ratios. Ratio relates one figure appearing in the financial statement to some other figure appearing there. A good example is the net profit in relation to capital employed. As a relative figure, this ratio is easily used for comparison (Attril, 2006:168). Although the calculation of a ratio is a prerequisite for decision-making, Gitman, (2010:54) emphasized that of the greatest importance is the interpretation of the ratio value. Interpretation can be done by comparing different business’ financial ratios at the same point in time, benchmarking the business ratios to the industry average or comparing the current ratios with those from the past.

2.1.6.3 Financing (Capital Structure)

Gandreau, (2005:5) defines capital structure as the relative amount of long-term debt and equity. In publicly traded companies, debt mostly consists of loans from financial institutions and debentures from institutional investors, while equity consists of ordinary and preference shares. Gandreau, (2005) further asserts that, capital structure is important because there exists in
practice a capital structure that minimizes the cost of capital and maximizes the value of the business.

Access to financing has an impact on the way in which the business is financed or the manner in which it structures its capital structure. Mutezo, (2005) revealed that, access to financing problems faced by small businesses influences and determines their capital structure. For instance, requirements of lending institutions and conditions in the equity markets make it difficult if not impossible for small businesses to obtain funds. This is caused by the fact that most small businesses fail in such a way that banks are exposed to a high risk when extending credit to them. To take high risk, banks require collateral and charge a high interest rate, which some of small businesses do not have or cannot pay. As a result, formal financial institutions structure their products to serve the needs of large businesses.

Small businesses are usually managed by their owners and available capital is limited to access to equity markets, and in the early stages of their existence owners find it difficult in building up revenue reserves if the owner-managers are to survive. A question concerns how small businesses determine sources of finance in such difficult circumstance. According to Brigham, (1995:447) modern capital structure theory began in 1958, when Modigliani and Miller’s determining article on capital structure was published. Since that point of time, researchers have attempted to explain how firms choose their capital structure.

2.1.6.4 Capital Budgeting (Investing)

Capital budgeting is concerning with planning for capital expenditure in acquisition of capital assets such as new building, new machinery or a new project as a whole. It includes mechanization of a process, replacing and modernizing a process, introducing a new product and expansion of the business (Paramasivan, C., and Subramanian, T., 2009:119). Capital budgeting is defined by different authors. For instance, few of them can be described as follows.

- According to Charles T. Hrongreen, “Capital budgeting is a long-term planning for making and financing proposed capital outlays.

- According to G.C. Philippatos, “a Capital budgeting is concerned with the allocation of the firm’s source of financial resources among the available opportunities”.

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- According to Richard and Green law, “a Capital budgeting is the acquiring inputs with long-term return”.
- According to Lyrich “Capital budgeting consists in planning development of available capital for the purpose of maximizing the long-term profitability of the concern”.

Brigham and Daves, (2004:2), also define capital budgeting as a whole process of analyzing projects and deciding on which ones to include in the capital budget. According to Chadwick and Kirkby, (1995:69) capital budgeting decision-making is done for a long-term period and normally involves the acquisition of fixed assets or the addition of a new product line.

Dhanmondi and Chowdhury, (2009:112) revealed there is only one capital budgeting theory of finance and the theory holds for all businesses regardless of size or kind. This being the case, managers should use the same criteria for investment in small businesses as are used for investment in larger businesses. Dhanmondi and Chowdhury, (2009:113) further suggest that, businesses should only make investment in projects or assets if such investment is in line with the goal of the business. In order to achieve the goal, capital budgeting principles must be applied when assets are purchased.

As Gitman, (2010:376) also argued, capital budgeting processes require that the relevant cash flows that increases as a result of investment be measured and the appropriate capital budgeting techniques be applied to decide whether or not the investment project should be accepted or not. Begemann, (2001:76), suggested that cash flows that should be estimated or which are normally distinguished for a capital budgeting process are: initial investment; expected cash flow per period over the expected life of the project; and expected terminal cash flow resulting from the termination of the project. Once cash flows have been developed, they must be analyzed using capital budgeting techniques to determine whether a project is acceptable or not.

Smart et al., (2007:322) in their part assert that, investment be undertaken when projects have positive net present value and are rejected when the net present value is negative. Because, positive net present value investment adds value to the firm. Nevertheless, Danielson and Jonathan, (2006:3-4) argue that there are various reasons to question the applicability of this theory to small businesses.
Small businesses also experience problems in accessing financing options like bank loans and public capital markets. These make them to maintain a sufficient cash balance in order to respond to profitable investment as it becomes available. Therefore, capital market constraints provide small businesses with economic reasons to be concerned about how quickly a project will generate cash or pay back to its initial investment (Padachi, 2006:47). Finally, Padachi, (2006:49) concluded that, small businesses turn to unsophisticated capital budgeting techniques such as the payback period rather than using sophisticated capital budgeting techniques.

2.1.6.4.1 Capital Budgeting Evaluation Techniques

By matching the available resources and projects it can be invested. The funds available are always living funds. There are many considerations taken for investment decision process such as environment and economic conditions (Paramasivan C., and Subramanian T., 2009:122). Taylor (2002) reveals that, capital budgeting techniques that are used include the payback period, accounting rate of return, internal rate of return and the net present value. Capital budgeting theory requires that the exercises of capital budgeting techniques should strive to achieve the goal of the business.

Fig. 2.2 Capital budgeting evaluation techniques

![Diagram of Capital Budgeting Techniques]

Source: Adopted from Paramasivan C., and Subramanian T., (2009:122)

**Pay-back Period** – is the time required to recover the initial investment in a project.
Post Pay-back Profitability Method – one of the major limitations of pay-back period method is that it does not consider the cash inflows earned after pay-back period and if the real profitability of the project cannot be assessed. To improve over this method, it can be made by considering the receivable after the pay-back period. These returns are called post pay-back profits.

Accounting (average) Rate of Return – average rate of return means the average rate of return or profit taken for considering the project evaluation. This method is one of the traditional methods for evaluating the project proposals.

Net Present Value – Net present value method is one of the modern methods for evaluating the project proposals. In this method cash inflows are considered with the time value of the money. Net present value describes as the summation of the present value of cash inflow and present value of cash outflow. Net present value is the difference between the total present values of future cash inflows and the total present value of future cash outflows.

Internal Rate of Return – Internal rate of return is time adjusted technique and covers the disadvantages of the traditional techniques.

Profitability Index – It identifies the relationship of investment to payoff of a proposed project.

2.1.6.5 Working Capital Management

Working capital refers to investment in short-term assets like cash, inventory and accounts receivable (Marx et al., 2010:183–184). Management of working capital is also an important part of financial manager. The main objective of the working capital management is managing the current asset and current liabilities effectively and maintaining adequate amount of both current asset and current liabilities. Working capital management is defined with different authors and researchers. For instance, some of them are presented as follows.

- According to Smith K.V, “Working capital management is concerned with the problems that arise in attempting to manage the current asset, current liabilities and the interrelationship that exist between them”.

- According to Weston and Brigham, “Working capital generally stands for excess of current assets over current liabilities”.

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So, from the above definition working capital management therefore, refers to all aspects of the administration of both current assets and current liabilities”. Marx et al., (2010), state that management of working capital involves decisions to determine the extent to which the current liabilities should be used to finance current assets. Current liabilities include short-term financing such as accounts payable and short-term loans. A cash conversion cycle is a key factor in the management of working capital.

**Cash management** - Identify the cash balance which allows for the business to meet day to day expenses. Effective cash flow management is vital for the success of the business. Cash moves continually through the business. The uneven nature of cash inflows and outflows makes it very important that cash flows be properly understood and managed (Moore et al., 2008:578). The primary tool for cash flow management is the preparation of a cash budget and management of the cash conversion cycle. As Atril, 2006 suggests that, a cash budget is a statement of planned inflows and outflows. It is used to estimate the business’ short-term cash requirements with particular attention to a plan for surplus or cash shortage.

Moore et al., (2008) state that, many small businesses that fail are profitable but, experience cash flow problems. Similarly, the study conducted by the University of Cape Town’s Graduate School of Business (2004) found out that 50% of small businesses have cash flow problems and almost 60% of them have exhausted their bank overdraft and failed to pay wages. To address the cash flow problems, government embarked on a strategy to help small business owners to access finance. However, Nieman et al., (2006) argue that, access to finance is not the solution to the problem as priority should be given to financial management training and particularly to cash flow management.

**Inventory management** - Identify the level of inventory which allows for uninterrupted production and minimizes reordering costs and hence increases cash flows.

**Debtor’s management** - Identify the appropriate credit policy i.e., credit terms which will attract customers, such that any impact on cash flows and the cash conversion cycle will be offset by increased revenue and hence return on capital or vice versa.
According to Smart et al., (2004) a cash conversion cycle represents the average days between the date when the firm must start paying its suppliers and the date when it begins to collect payment from its customers. The decision about how much to invest in accounts receivable and inventory and how much credit to accept from suppliers is reflected in the business’ cash conversion cycle. The proper management of working capital should give a desired impact in profitability, liquidity or risk. The balance among profitability, risk and liquidity should be maintained in the management of working capital at all times (Gitman, 2010).

Decisions that tend to increase profitability tend to increase risk, and on the contrary decisions that focus on risk reduction will tend to reduce potential profitability (Teruel and Solano, 2007:164). As Gitman, (2010:629) recommends that, liquidity is necessary to support the cash needs of the business but, should not be achieved at a high cost, which may translate to low profit and high risk. High profit must be accompanied by enough cash flow, which will enable the business to meet its short-term obligations. Padachi, 2006:47 argued that, profitability should be translated into cash from operations within the same operating cycle in such a way that, the business does not need to borrow to support its working capital needs. In this way, the objectives of profitability and liquidity would be matched. This is necessary because, working capital management is of particular importance to the financial health and success of businesses of all sizes.

Even though, the efficient management of working capital is critical to businesses of all sizes, it is the small businesses that should address this issue more seriously (Padachi, 2006:45-48). The amount of capital invested in working capital of small businesses is often high in proportion to the total assets employed as compared to larger business. Small businesses have limited access to long-term capital markets, and they tend to rely more heavily on owner financing, trade credit, and short-term bank loans to finance their required investment in cash, accounts receivable, and inventory as compared to large businesses. However, study by Padachi (2006:45-48) point out that, small businesses are not very good at managing the working capital as a result most of them fail.
2.1.6.5.1 Working Capital Policies

Working capital policy involves decisions about company’s assets and liabilities – what they consist of, how they are used, and their mix affect the risk versus return characteristics of the company (Meyer et al., 1992). Western and Copland, (1989) identified two working capital policies. The first policy deals with the determination of the level of total current assets that should be held by the firm. And the second policy confronting management concerns the relationships among types of assets and the way these assets are financed. Typical, working capital policy decisions involve a determination of the appropriate level of cash, accounts receivable, and inventory that the firm should maintain (Block and Hirt, 1992).

2.2 International Empirical Evidences

Different researchers have been carried out on the financial management practices of small firms in different periods in different levels of economies. So, various empirical studies done by prior researches have to be observed so as to find out those gaps in the existing literatures. Accordingly, this part of the paper summarizes some most recent available empirical evidences related to the issues of the study among others consecutively.

McMahon et al., Forsaith, (1993), and McMahon, (1993) summarize their review of financial management practices of small firms in Australia, the UK and the USA respectively. In their study, accounting information systems, financing decisions, investing decisions are included the context of financial management practices and argued that, the management decisions have positive relationship with firms performances. However, these previous researchers though looked into financial management; they didn’t try to see other key areas of financial management like financial planning and control, financial statement and analysis, and working capital management.

Ashim and Nikhil, (2005), also explore the financial management and analysis practices of small firms in India. The authors argued that, there exists a wide gap between theory of financial management and in actual practices by the small business in India. Furthermore, the researchers point out that, firms not doing well are less likely to have knowledge on financial management and proper business records. Nevertheless, the authors didn’t clearly prompt the challenges face
with small firms in practicing sound financial management practices and neither set out which specific areas of financial management of small firms requires special attentions.

Agyei-Mensah, (2011) also studied financial management practices of small firms in Ghana. The author argued that the owner-managers of the sample firms will not prepare any management accounts. In this regard, the profits made by an entity can only be measured by preparing financial statements otherwise; it is very difficult for the owner-managers of the small firms to be able to compute their profits. Moreover, the researcher point out that, the inability of small firms to make use of computerized accounting systems also act as a barrier to the successful implementation of sound financial management practices. Nevertheless, the author did not observe other key specific areas of financial management of small firms such as financial planning, financial statement analysis, and capital structure decisions because, these specific areas are interrelated and work together with one another during operations.

Kayseri and Laturkar, (2011) on their part studied the financial management in small scale industries in India. Then, they conclude that, small business financial management is a vital aspect of growing a profitable company. Further, they identified that, implementing sound economic principles and keeping a close watch on cash flow will help lay a solid financial foundation for the new business enterprise. Again, they recommended that, monetary policies and procedures for effective cash management need to be part of the entrepreneur's business plan. However, their study was specifically limited to areas of cash management. That is, other important components of financial management were not considered in their study. Moreover, the authors did not tried to identify the effects of cash managements on firms’ performances neither set out the root causes of the challenges for small firms’ financial management. Further, they didn’t briefly summarize the gap between financial management theories and the real application in small business sectors.

Regina, (2012) on his part evaluated whether the financial management practices of small firms in Nigeria impacted on their profitability, growth, and survival. The author in his study used five variables such as accounting systems, financial management information, working capital management, budgeting practices and managerial planning. His findings shown that, a number of
factors inhibit the preparation and presentation of financial information by small businesses. He identified those factors such as lack of qualified staff, the inability of owner managers to realize the right of stakeholders to have access to such information, and inability of firms to appoint qualified accountants to provide such information. Again, he justified that, the state of accounting and financial management practice remains inadequate among small businesses in Nigeria. The study also reveals that, these five variables have significant impact on the survival, growth, and profitability of small firms. Finally, he recommended that, small firms are therefore, advised to employ the services of qualified accountants in order to improve their financial management practices to enhance their overall performance. Nevertheless, the researcher didn’t bother about capital structure (financing) decisions because deciding the suitable capital structure is the important decision of the financial management; because it is closely related to the value of the firm.

Abanis et al., (2013) evaluated the extents of financial management practices of small and medium enterprises in selected districts of western Uganda. Their findings revealed that, the extent of financial management is low among SMEs. But, they didn’t clearly identified factors that contributed to low level of performance of small firms in financial management practices.

2.3 Domestic Empirical Evidences

Although, in the developed economies, financial management studies have been extensively carried out, the same cannot be said of the emerging economies like Ethiopia. In case of Ethiopia, to the best of my knowledge, it appears serious academic studies on financial management practices of small business sectors are very scarce. For instance, Zeleke, (2009) conduct a comprehensive study on Efficiency in management as a determinant of long-term survival in micro, small and medium enterprises in Ethiopia.

His study was focused on a six year long survival analysis of 500 small businesses enterprises selected from five geographical regions of Ethiopia (Addis Ababa, Awassa, Bahir Dar, Adama, and Mekele). The study shows that, efficiency in management is a key determinant of long-term survival. The author in his study argues, businesses in which finances and resources were not managed efficiently were 5.49 times more likely to fail in comparison with businesses whose
finances and resources were managed efficiently. Finally, he recommends the promotion of capacity building in managerial and technical skills as well as improved access to finances to small businesses and enterprises in Ethiopia. The study has shown that viable businesses have utilized their resources efficiently, and that their managerial and technical skills are much better than those businesses that did not survive the study period. Nevertheless, the researcher did not prompt which management areas (financial management, marketing management, production management, and human resources management) are the most pressing problems for those firms under study. Again, although, his study was more comprehensive, he didn’t try to separately evaluate the management efficiency of business sectors as micro, small and large firms, as if they are still different in their nature and finally he forwards a general conclusion.

Derese and D. Prabhakara, (2012), on their part, evaluate the effect of financial management practices and characteristics on profitability on sampled business enterprises in Jimma Town, Ethiopia. Their finding reveals that, the efficiency of financial management practices and characteristics can bring about higher profitability. Again, they recommended that, business organizations can improve profitability by raising the efficiency of financial management practices and characteristics. The researchers further suggested that, financial management practices and characteristics have positive relationship with firm’s performances. Nevertheless, the authors in their study did not separately evaluate businesses as micro, small, small and medium, and large firms for the purpose of their study. Because, it is real that, business firms as micro, small and medium, and large have no the same interpretation and the extent of their financial management practices may not necessary the same. For instance, in US survey on the differences between large and small firms, Walker and Petty, (1978) reached the conclusion that; the liquidity of small firms was much lower than that of large businesses. Therefore, it is very difficult to give a general conclusion without having separate evaluation of business firm’s financial management aspects.
2.4 Gaps in the Literatures

From the above discussions of some international and domestic empirical evidences one can detect that most empirical evidences relatively reflect the financial management aspect of small firms of developed economy like USA, UK, and India etc. This implies that, there is lack of empirical evidences in emerging economies like Ethiopia on small businesses financial management practices. Now days, the empirical evidences on financial management practices of small businesses in Ethiopia are appears to be scarce. Moreover, to my knowledge, there is no previous study specific to the financial management practices of small firms in Ethiopia and there is no prior study conducted in Jimma Zone, Sokoru District in particular to the issues of small firm's financial management practices. That's why the researcher mainly focused on the study financial management practices of sampled small business firms of Sokoru District (Sokoru Town) to provide empirical evidence by filling those gaps that prior researchers or authors bothered little or no to see the performance of financial management practices of small firms, and factors that inhibit the application of sound financial management practices.
CHAPTER THREE

3. RESEARCH METHODOLOGY

This study was aimed to assess the financial management practices of small firms in Sokoru District (Sokoru Town). So, in order to achieve the objective of the study the following methodologies were employed.

Basically, there are three kinds of research approaches that are used by various researchers in their study by evaluating the applicability of each approach. These approaches are quantitative, qualitative, and mixed approaches. For the purpose this study, mixed-approach was employed because, the researcher believes that adopting mixed approach reduces the possibility of personal and also by not depending on only one approach. In this regards, the nature of the survey was the cross-sectional, because it was possible to obtain the desired information at one time. A combination of dichotomous and Likert scale questions were used for the survey. Statistical analysis was based on descriptive statistics.

3.1 Types and Sources Data

In this study the primary data were obtained from the sampled owners of small firms and trade and industry office of Sokoru District. The data relevant to the issues of the study were collected using questionnaires. Then the questionnaire was translated into Amharic language for easy understanding of the respondents by the researcher prior of distribution. In addition, the researcher used structured interviews based on open-ended questionnaires to obtain information from trade and industry office of Sokoru district.
3.2 Sample Size Determination

Basically, for scientific research the appropriate sample size has to be clearly determined by using various models based on the nature of the study. Therefore, in this study for the purpose of sample size determination Cochran, (1977) statistical model was used. Accordingly, the appropriate sample size used for this study at 90% of level of significance with marginal error 10% was determined using the following Cochran formula.

\[ n = \frac{(Z_{\alpha/2})^2 \cdot P \cdot (1-P)}{D^2} \]

Where,

- \( n \) = Sample size
- \( (Z_{\alpha/2})^2 \) = Level of significance
- \( D \) = Marginal error
- \( P \) = indicates the ratio of small firms who have some ideas about the financial management issues

Here, the researcher used ‘P’ value of 0.50, as standard for this study because, to my knowledge there were no prior study that shows ‘P’ value that can be taken as standard for the purpose of the study.

The reliability co-efficient at the significance level of 90% = 2.56. Thus, the sample size can be computed as follows.

\[ n = \frac{(2.56)^2 \cdot (0.5) \cdot (0.50)}{(0.10)^2} \]

\[ n = 164 \]

According to the data obtained from Trade and Industry Office of Sokoru District, in Sokoru Town there were 233 licensed business firms until January of 2014. However, only 115 of them were identified as small firms that can be used for the purpose of the study, while the remaining firms were considered as micro-enterprises. So, it known that for the total population less than 10,000 the sample reduction formula can be applied. Hence, the total population (N) of this study was equals 115 which is less than 10,000. So, the sample can be reduced using the sample reduction formula as follows.
\[
n = \frac{n}{1 + \frac{n}{N}}
\]
\[
n = \frac{164}{1 + \frac{164}{115}}
\]
\[
n = 68
\]

However, the researcher considered 3% none-response rate which was 2 (164 x 0.03), and then, this was added on the calculated value of ‘n’ and it resulted a total sample size of 70. Therefore, totally 70 samples were taken out of 115 small firms for this study.

### 3.3 Sampling Techniques

The sampling technique employed for the purpose of this study was both stratified and simple random sampling. So, from the total population of small firms (N = 115), 58, 40, and 17 of them were stratified as Merchandises, Services, and Manufacturing businesses enterprises respectively as data obtained from trade and industry office of the district. But, as it was mentioned before, for the purpose of the study totally 70 small firms were selected. Accordingly, from each stratum as merchandises 35, services 24, manufacturing 11 were obtained by applying simple mathematical completion and then, the questionnaires were randomly distributed to owners of small firms by the researcher after providing the purpose of the study to the respondents and obtaining their consents with smooth approach. Then after one day of distribution the researcher collected back the questionnaires for analysis.

### 3.4 Data processing, Analysis, and Interpretation

For the purpose of data analysis the descriptive statistics was employed. After having collected, all the relevant data, data processing such as editing, coding, and data entry were made. Next, to visualize the data frequency tables, bar graphs, and pie charts were used to facilitate the interpretation processes of the data using percentage and frequencies. Lastly, from the premises specified in the analysis and interpretation sections the researcher drawn the findings and forwarded the conclusion and recommendations.
CHAPTER FOUR

4. DATA PRESENTATION AND ANALYSIS

This chapter presents, analyzes, and discusses the data gathered from the survey of small firms. The data were represented by bar graphs, pie-charts and tables. Data were also presented in relation to the related literature review and compared to the data collected from the survey of small firms to achieve the study objectives.

4.1 Response Rate

In order to achieve the objectives of the study 70 self-administered semi-structured questionnaires were randomly distributed to the sampled small firms with an expected return of 68. But, actually 53 questionnaires were collected back and posting a response rate of 76%; whereas the remaining 24% did not. Details are shown in figure 4.1 below.

Fig.4.1: Response Rate

Source: Small business survey, Feb., 2014
4.2 Respondent Characteristics

This section presents information about the demographic characteristics of the respondents in terms of gender, level of education, number of employees, and type of firm.

4.2.1 Gender of the Respondents

As presented in the figure 4.2 above, a significant majority of the respondents were male. This accounted for a proportion of 90% as compared to 10% of the respondents who were female. This implies that, most small business firms are owned with men. For instance, in Sokoru District from every ten small business enterprises nine are owned by men as compared to one by women.

Source: Small business survey, Feb., 2014
4.2.2 Education Levels of the Respondents

Fig. 4.3 Distribution of Education Levels of the Respondents

Source: Small business survey, Feb., 2014

Regarding with the education levels of the respondents the study revealed that, 54% and 40% of owners of small firms attained primary and secondary school respectively; whereas, the remaining 6% were diploma holders and none of them hold degree and above. Basically, the knowledge of accounting system practices are usually depends on the competence and level of education that an individual holds. So, the implication to these findings is that, most owners of small firms have no sufficient education in order to manage their finance. Figure 4.3 above shows details.
4.2.3 People Employed

As it can be seen from figure 4.4 above, around 92% of small firms’ employees between 6 and 10 – especially those who in manufacturing and service sectors; where as 2% of the respondents employ below 6, and 6% of the respondents were employees between 11-15. Lastly, none of the respondents employ above 16. This analysis shown that the majority of small firms in Sokoru District employ between 6 -10 employees.
4.2.4 Business Type

For the purpose of this study the survey of three types of firms engaged in merchandizing, services, and manufacturing enterprises were used. Accordingly, figure 4.5 above depicts 57% and 27% of the small firms are engaged in merchandizing and service business sectors and the remaining 16% of them are engaged in manufacturing sector. This implies that, merchandise firms constitute a sizeable number of small business enterprises in Sokoru Town when compared to service and manufacturing sectors.

Source: Small business survey, Feb., 2014
4.3 Specific Areas of Financial Management

Table 4.1 Financial Planning, Analysis, and Control

<table>
<thead>
<tr>
<th>Particulars</th>
<th>Never</th>
<th>Sometimes</th>
<th>Always</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Fre.</td>
<td>%</td>
<td>Fre.</td>
</tr>
<tr>
<td>Do you:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Set short-term financial objectives?</td>
<td>52</td>
<td>98</td>
<td>1</td>
</tr>
<tr>
<td>Set long-term financial objectives?</td>
<td>52</td>
<td>99</td>
<td>1</td>
</tr>
<tr>
<td>Compare Financial plan with performance?</td>
<td>52</td>
<td>98</td>
<td>1</td>
</tr>
<tr>
<td>Analyze the trend of your sales?</td>
<td>50</td>
<td>95</td>
<td>3</td>
</tr>
<tr>
<td>Analyze the trend of your cost?</td>
<td>52</td>
<td>98</td>
<td>1</td>
</tr>
<tr>
<td>Analyze the trend of your profit?</td>
<td>51</td>
<td>96</td>
<td>1</td>
</tr>
</tbody>
</table>

Source: Small business survey, Feb., 2014

With regards to financial planning, analysis and control, the result of the study found that 98% and 99% of the respondents never set short and long-term financial objectives; while 2% and 1% of the respondents sometimes set short and long-term financial objectives respectively. Again, 98% of the respondents never compare their financial plan with their performances. In addition, 95%, 98%, and 96% of the respondents do not undertake financial analysis to determine the trends in sales, costs, and profit. Furthermore, 5%, 2%, and 4% of the respondents do financial analysis sometimes to see the changes in sales, costs, and profit. Lastly, the study points out that none of the respondents always undertake financial planning, analysis, and control. As per the results of the findings, the majorities of small firms do not engaged in financial planning, analysis and control – especially due to lack of adequate financial management skills. This implies that, small firms have no further financial plan and unable to compare their financial objectives with actual performances – in the same fashion, they do not made the analysis of their sales, costs, and profit in order to minimized costs and increasing profit (Table 4.1).
Table 4.2 Do you prepare monthly Financial Statements

<table>
<thead>
<tr>
<th>Response</th>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>No</td>
<td>51</td>
<td>96</td>
</tr>
<tr>
<td>Total</td>
<td>53</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Small business survey, Feb., 2014

As shown in Table 4.2 above, 96% of the respondents do not prepare monthly financial statements; whereas only 4% of the respondents prepare monthly financial statements. This indicates that, monthly financial statement reports are not adequately maintained in small firms.

Fig. 4.6 Factors hindering monthly financial statements preparation

Source: Small business survey, Feb., 2014

Figure 4.6 above presented factors that hinder owners of small firms from preparing monthly financial statements. Accordingly, 60% of the respondents do not prepare monthly financial statement because of lack of awareness about financial statements and basic knowledge to those areas; while 21% of the respondents fail to do so – because it is costly to maintain professional accountants. In addition, 4% of the respondents pursuing monthly financial statements are not necessary for small firms. Lastly, 15% of the respondents do not prepare monthly financial statement due lack of follow up and strong external control – especially internal revenue.
authorities and trade and industry bureau. This implies that, lack of knowledge and experts are the major barriers to prepare monthly financial statements for small firms.

Table 4.3 Accounting Information Systems

<table>
<thead>
<tr>
<th>Accounting Information practices</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Fre.</td>
<td>%</td>
</tr>
<tr>
<td>Maintain sales books?</td>
<td>14</td>
<td>26</td>
</tr>
<tr>
<td>Have purchase books?</td>
<td>39</td>
<td>73</td>
</tr>
<tr>
<td>Maintain expenses books?</td>
<td>8</td>
<td>15</td>
</tr>
<tr>
<td>Have a stock book?</td>
<td>23</td>
<td>43</td>
</tr>
<tr>
<td>Have a computer for records keeping?</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Maintain a record for fixed asset?</td>
<td>3</td>
<td>6</td>
</tr>
<tr>
<td>Conduct depreciation for your plant assets?</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Make drawings from your business?</td>
<td>53</td>
<td>100</td>
</tr>
<tr>
<td>Record your drawings?</td>
<td>15</td>
<td>28</td>
</tr>
</tbody>
</table>

Source: Small business survey, Feb., 2014

As indicated in Table 4.3 above, 74% of the respondents do not maintained sales books – mainly those in service sector; however, only 26% of the respondents maintain the same. In addition, 73% of the respondents have purchase books; while the remaining 23% have not – especially those in service sector. In the same way, around 85% of the respondents do not maintain expenses books; but, only 15% of them maintain expense books. Furthermore, around 57% of the respondents do not have stock books; while 43% have stock books. Additionally, none of the respondents have computer to keep their accounting records. Similarly, 94% of the respondents do not maintain records for their fixed assets but, only 6% of the respondents maintain records for their fixed assets. Also, none of the respondents have any provision for depreciation of long-lived assets. Lastly, all (100%) of the respondents made drawings from their businesses; but, 72% of the respondents do not record for their drawings and the remaining 28% record their drawings. This shows that, the majority of small business firms do not effectively use accounting
information system in order to determine their financial performance. Further, it implies that, the computerized accounting system practices of small firms are also insignificant.

Table 4.4 Working Capital Management

<table>
<thead>
<tr>
<th>Working capital management practices</th>
<th>Yes</th>
<th>No</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Fre.</td>
<td>%</td>
</tr>
<tr>
<td>Do you:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prepare a cash budget?</td>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>Sell on account?</td>
<td>39</td>
<td>74</td>
</tr>
<tr>
<td>Purchase on account?</td>
<td>42</td>
<td>79</td>
</tr>
<tr>
<td>Made daily deposit in a bank?</td>
<td>5</td>
<td>9</td>
</tr>
<tr>
<td>Determine an average days between the collections and repayments?</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: Small business survey, Feb., 2014

With reference to working capital management practices of small firms the study showed that, around 96% of the respondents do not prepare a cash budget or a statement of planned inflows and outflows. Additionally, 74% of the respondents sell their product on account; nevertheless, 26% of the respondents do not sell their product on account – mainly those who are in service business. Again, 79% of the respondents purchases on account; likewise 21% do not. The study result also revealed that 91% of the respondents do not keep their money in a bank on a daily basis. Moreover, none of the respondents undertake cash conversion cycle. This implies that, small firms are weak in working capital management practices – especially in areas of maintaining cash budget and in the provision of Cash Conversion Cycle (Table 4.4).
Source: Small business survey, Feb., 2014

Refers to mechanisms for taking an inventory, the findings revealed that more than half (51%) of small firms do not take for specified periods. However, 9% and 40% of the respondent take an inventory on the monthly and yearly basis respectively. Likewise, none of the respondent daily made an inventory. The implication of this finding is that the inventory management practices of small firms are inadequate. Fig. 4.7 above shows details.
As to how the small business owners decided for re-stocking the survey results indicated that most of the respondents (73%) made restocking when stock is down – especially those in merchandize businesses; whereas, 12% and 15% of the respondents made restocking periodically and based on the projected sales respectively. In addition, 5% of the small firms undertake re-stocking using customer demand. Lastly, none of the respondents make use Economic Order Quantity Model for replacing their stock. This evidence indicates that, the majority of small business owners undertake re-stocking when the level of the stock diminishes (Fig. 4.8).

<table>
<thead>
<tr>
<th>Response</th>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>16</td>
<td>32</td>
</tr>
<tr>
<td>No</td>
<td>37</td>
<td>68</td>
</tr>
<tr>
<td>Total</td>
<td>53</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Small business survey
As it can be seen from the table 4.5 above, the majority of the respondents (68%) of the respondents did not evaluate the feasibility of their investment before starting operations. However, only (32%) of the respondents evaluate the feasibility of their investment before starting businesses. The implication to these findings is that, most small business firms did not assess the viability of their investment projects before starting the business so as to maximizing the long-term profitability.

Table 4.6 Techniques for evaluating feasibility of investment

<table>
<thead>
<tr>
<th>Response</th>
<th>Frequency</th>
<th>Percentage (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payback</td>
<td>16</td>
<td>32</td>
</tr>
<tr>
<td>Accounting rate of return</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Net present value</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Post Pay-back Profitability</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>16</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: Small business survey, Feb., 2014

Table 4.6 further presents the capital budgeting techniques in use. Accordingly, from these respondents that evaluating the feasibility of their investment before starting operations 16(100%) use the payback methods; while, the remaining capital budgeting techniques –like accounting rate of return, net present value, post pay-back profitability are not in use. This implies that, payback period is more convenient dominant method in small firms as compared to other methods such as, accounting rate of return, net present value, and discounted cash flows.
Concerning with source of financing the study showed that 62% of respondents financed their capital investment projects using retained earnings; whereas 19% and 9% of the respondents were raised their funds through loan from micro finance and from banks respectively. In addition, 6% of the respondents raise their funds through loan from their relatives and families. Likewise, 4% of the respondents obtained funds from other sources such as traditional financial institution like ‘Iqub’. This explains that, most small business firms finance their operations for first stance using their own earnings and next looking for additional external sources (Fig. 4.9).
Fig. 4.10 Factors affecting Investing / Financing decisions

Source: Small business survey, Feb., 2014

Fig. 4.10 above presented factors that influencing the financing decision of owners of small firms. So, 75% of the respondents do not have access to financing because of higher collateral required. Similarly, around 25% of the respondents have no access to financing due to higher interest rates and other economic variables such inflation and government policies. This indicates that, the most pressing problems that facing with small firms are the fact that higher collaterals are imposed by banks.
On the issues of pricing strategies the study showed that, the majority (70%) of the respondents use cost-plus pricing method – especially those who are in merchandize business firms. Moreover, the survey also reveals that some of the respondents (18%) – especially those involve in service sector exercise competition based pricing strategies and 4% and 8% of them use value based and target rate of return methods respectively. It implies that, Cost-plus pricing strategy is the most dominant and convenience pricing strategy for those small firms (Fig. 4.11).
With reference to goal of the firms, most of the respondents (87%) revealed that the goal of their firm is profit maximization. In addition, few (9%) of the respondents – particularly those who are in the manufacturing were pursuing to have large market share; likewise very few (4%) of the respondent were pursuing to provided customer satisfaction and lastly none of the respondent were pursuing to wealth maximization. So, this implies that in a small business environment, the financial goal is to attempt for profit maximization at large as compared to other objectives (Fig. 4.12). 

Source: Small business survey, Feb., 2014
4.4 Interview Results

Finally, in order to complement the information obtained from owner-managers of small firms interviews also made with the management of Trade and Industry office of Sokoru District regarding with financial management aspects of small firms. Accordingly, their response to the provision of training programs for small firms is that, there are no formal training regularly provided for them specifically to areas of financial management. However, sometimes there are some provisions of awareness creating programs to the entire businesses on general issues.

The other basic finding of the interview was that, there is no regular follow up measures weather small firms keep proper accounting records or not. Rather, they replied that, internal revenue bureau make follow ups financial statements of small firms to some extents for the provision of tax. In addition, the interview results shown that, the most pressing problems facing with small firms is that, most small firms make their business practices with traditional basis. Owner-managers have no accounting knowledge that enables them to manage their finance properly and with low level of educational basis. This implies that, the overall performance of small firms of Sokoru District in financial management arena appears to be weak.
CHAPTER FIVE

5. FINDINGS, CONCLUSIONS, AND RECOMMENDATIONS

5.1 Summary of the Findings

This chapter presents the research findings, conclusions, and the recommendations for the study. The discussions, conclusions, and recommendations were made in accordance with the research objectives. The study explored the performances of owners of small firms in practicing financial management and factors that inhabit the application of sound financial management practices of small firms in Sokoru District were also assessed.

The study shown that, most small firms are owned by men with the ratio of nine to one with low level education basis by employing mostly between 6 and 10 employees. In addition, the study showed that, merchandize firms constitute a sizeable number of small firms.

The findings revealed that most small firms (more than 95%) do not engage in financial planning, analysis, and control. Most respondents do not set short and long term financial objectives; do not analyze the trend in sales, cost and profit. Basically, a plan allows a business to set certain goals for the business and to measure expectations against actual performances. So, as far as small firms have no plan most of them do not compare their goals with performance. Similarly, the fact that small firms did not engaged in the analysis of their sales, costs, and profit as a result they unable to maximizing profit by minimizing costs. The study also indicated that, small firms have poorly practicing financial planning, analysis and control – mainly small businesses have no awareness and experience on those areas. These findings agree with the study by Amin, (2004) that investigated small firms fail because of lack of planning.

Although, the profits made by an entity can only be measured by preparing financial statements. The study points out that, 96% of small firms do not prepare those basic monthly financial statements such as income statement, balance sheet, and statement of owner’s equity. Thus, it is very difficult for the owners of the small firms to be able to compute their profits when they do not prepare financial statements. The findings also indicated that, small firms are not engaged in the preparation of these financial statements – especially due to lack of adequate knowledge, lack
professional accountants, and no follow up with the government bodies – particularly trade and industry bureau and internal revenue authorities. This confirms the findings of a study done by John, (2008) that found small business owners were good in selling their products and services but disliked numbers. They did not compile the financial statements because they could not read it and were too busy to do it. Further, John (2008) observed that few small business owners compile financial statements because government compels them to do so in order to report their income every year. This study also collaborated with the study by Agyei-Mensah, (2011) that point out 60% of small firms in Ghana do not engaged in the preparation of basic financial statements.

The study showed that accounting information system practices of small firms were mixed in the sense that, most of the respondents maintained purchases books and make drawings from their business. However, most of the respondents do not maintain expenses books, stock book, drawings books and, fixed assets record. The finding also indicated that, all of the small firms do not have computer to maintain records for their transactions. As Amidu et al., (2011) indicated that, the use of computers for record keeping with small firms’ results in time and cost effective – this implies that still small firms are un able to cope up with the existing technology rather they engaged in traditional accounting practices in which records are keep manually. Likewise, small firms entirely do not undertake any provision for depreciation of their plant assets. So, small firms do not maintain proper records for the depreciation of their plant assets.

Accounting information systems provide a source of information to owners of small firms operating in any business. In addition, accounting information system helped owners of small firms to design and implement a strategic plan so as to make positive profit in long run. Therefore, it is necessary that, the accounting practices of small firms provided complete and relevant financial information necessary to get better economic decisions made by the owner’s of the businesses. Nevertheless, the fact that small firms do not maintain proper records and key books they incapable to determine easily their financial performances; at the same time these literary affect the growth and survival of small firms.
The result also found that most small firms do not maintain complete accounting records mainly due to lack of accounting knowledge of the owners. These findings supported the most recent study by Maseko and Manyani, Agie-Mensah, (2011) that most small businesses do not maintain complete accounting records due to lack of accounting knowledge.

Regarding with working capital management, the majority (96%) of the respondents do not prepare a cash budget; whereas none of the small firms conduct cash conversion cycle. The primary tool for cash flow management is the preparation of a cash budget and management of the cash conversion cycle – because of these facts small firms cannot estimate their business’ short-term cash requirements with particular attention to a plan for surplus or cash shortage. The results also revealed that, majority of the small firms sell and purchase their goods and services on account. But, few in service business do not offer their product to sell on account. The majority (91%) of small firms’ also do not deposit their daily sales in a bank. This can also be literary affect deposit history of small firms and determine their credit worthiness’s. As Padachi (2006) suggested that as efficient management of working capital is vital to businesses of all sizes, it is the small businesses that should address this issue more seriously. However, this finding shown that, small business appears poor at managing the working capital – mainly because of lack of awareness and enough knowledge to those areas of working capital. These results are consistent with the findings by Padachi, (2006) that small firms are not very good at managing their working capital – as a result, most small firms fail. Similarly, the results are confirmed study by Moore et al., (2008) that many small firms that fail are profitable; but, experience cash flow problems. Further, the results are supported the study by the University of Cape Town’s Graduate School of Business, (2004) that 50% of small firms have cash flow problems and almost 60% of them have exhausted their bank overdraft and failed to pay wages.

The results under provisions for taking an inventory shown that, more than half (52%) of the small firms do not make an inventory for identified period of time such as daily, monthly, and annually. So, from this fact one can observed that the inventory management practices of small firms appear to be inadequate. Nevertheless, as Clodfelter, (2003) point out that, without inventory control procedures in place, the stores department can become overstocked or under stocked and also inventory control systems provide a business with information needed to take
markdowns by identifying slow selling merchandise. Determining such items on time would allow a business to reduce prices or make a change in marketing strategy before shift in consumer demand. In fact, in the absence of these realities, the relationship between sales and inventory of the small firms do not maintain properly.

The finding also sought out that, the majority (73%) of small firms made the provision of re-stocking when their stock is down as compared to 27% of them those who made re-stocking regularly based on projected sales, and customer demands. Nevertheless, the fact that none of the small firms use Economic Order Quantity – it became irrelevant to small firms. This result supports the findings by Agyei-Mensah, (2011) that revealed economic order quantity is irrelevant for small firms.

With reference to the investment feasibility evaluation of small firms the results investigate that the majority (68%) did not evaluate the feasibility of their investment before starting the business. This is mainly due to lack of knowledge and experience in the line; that is the owner has entered a business field in which he or she has very little knowledge. Brigham, (1992) suggested that, capital budgeting might be more important to a smaller firm than its larger counterparts because of the lack of access to the public markets for funding. So, the viability of the business has to be determined whether or not the investment project should be accepted or not. In addition, Peel and Bridge, (1998) point out that capital budgeting and planning positively impact on the performance of small firms. Thus, in the absence of these practices small firms could not assess their long term risks and returns. This can also be negatively impact the growth and survival of small firms.

The survey results shown that only 16(32%) of the respondent evaluate the viability of their investment before starting businesses. Accordingly, from those small firms who conduct the feasibility of the business before operation all 16(32%) of them used the payback period method. In this case, other capital budgeting techniques such as accounting rate of return, net present value, and post pay-back profitability became difficult for small firms. These findings supported study by Louma, (1967) that conducted a survey of small and medium-sized manufacturing businesses in the United States and found that more than 63% of SMEs used payback period of
capital investment evaluation techniques. Further, Louma, (1967) suggested that payback period method are the most popular technique used by small firms while more sophisticated techniques such as net present value, and accounting rate of return seem to be less frequently used. Again, the results are collaborated with the study by Block, (1997) that conduct survey of 232 small businesses in the USA indicated payback method remains the dominant method of investment selection for small businesses. The results also consistent with the study by Agyei-Mensah, (2011) that conducts a survey of 25 small firms in Ghana and found that 36% of small firms used payback period of capital budgeting evaluating methods.

Evidences shown that, the predominance of the payback period method can be attributed to its simplicity, emphasis on liquidity, and response to external financing pressures while other more complicated methods are not as popular. Similarly, Grablowsky and Burns, (1980) found that, the level of understanding and use of more advanced capital budgeting polices and techniques were very low. For instance, Padachi, (2006) suggested that, small firms turn to unsophisticated capital budgeting techniques such as the payback period rather than using sophisticated capital budgeting techniques like net present value, and average rate of return and the like. In fact, it is impossible because, many small firms have lack expertise in financial management and accounting; as a result, these firms may not be able to make reliable estimates of future cash flows.

Under capital structure decisions the result shown that the majority (62%) of small firms use retained earnings as a major source to finance their investments; whereas, 38% of the small firms used other alternatives from external sources such as loan from banks, micro finances, and relatives. These findings support the Peaking Order Theory of Myers, (1984). This theory suggests that, there is no well-defined optimal capital structure; instead the debt ratio is the result of hierarchical financing over time. The foundation of Peaking order theory is that firms have no defined debt-to-value ratio. Owner-managers have a preference to choose internal financing before external financing. When a firm is forced to use external financing sources, owner-managers select the least risky and demanding source first. These results are consistence with the study by Norton, (1991), and Abanis et.al, (2013) that revealed small enterprise seemed to make financial structure decision within a hierarchical or pecking order theory.
The study points out that, around 75% of the small firms have no access to financing due to the fact that higher collateral requirements by formal financial institutions; whereas, around 25% of small firms do not have access to finance because of high interest rate and other economic variables such as inflation and government policies. Year after year, different empirical evidences shown that small scale enterprises frequently suffer from a particular financial problem of lack of a capital base. In fact, this appears true, because, high collateral requirement by lending institutions and high interest rates charges are some obstacles that some of small firms do not have or cannot pay. As a result, formal financial institutions structure their products to serve the needs of large businesses (Mutezo, 2005). This argument is similar to the previous studies by Fetene, (2010) that found 46% of the small firms in Ethiopia facing with financing problems because of insufficient collateral requirements.

Under the pricing strategies the result found that 70% of small firms used cost- plus pricing method; while 30% small firms used other pricing strategies like competition based pricing, target rate of return, and value based pricing strategies. Cost-plus pricing is the simplest pricing method determined by adding standard mark up in the cost of the product. The fact that cost-plus pricing is the simplest pricing strategy among others it appears that is why it is commonly used by small firms who are well known with lack of accounting knowledge and financial management skills.

The finding investigated that 87% of small firms were pursuing that profit maximization is the main reason for existence of small firms as compared to those insignificant number (13%) of small firms having other objectives other than maximizing profit. Although, various objectives are possible in the business, the most commonly accepted objective for the business is to maximize the value of the firm to its owners. In fact, it is unquestionable that, profit is the motivational factor behind to start and keep the business. In these findings the fact that, none of the small firms did not pursuing to wealth maximization – it implies that wealth maximization is became irrelevant for small firms. Small firms often exhibit differences in their objectives for running their businesses well away from the traditional shareholder’s wealth maximization concept. Rather, small firms aimed at having a job, providing income to the owner-manager, and growing the business in terms of income through sales of their products. This result confirms the
findings of Avlonitis and Indounas (2005), and Obigbemi (2010) that found profit maximization is the primary objective of small firms.

As interview results made with trade and industry office revealed that, there is no formal training provided for small firms specifically to the issues of financial management practices. As per the management of the office response to the interview, lack of formal planning is a major inhabiting factor to provided training services. Moreover, the finding indicated that the follow ups and supervisions of small firms accounting records are very poor. Again, interviewee the other pressing problems observed in small firms were traditional ways of making a businesses, low base of education, lack of managerial experience, and lack of financial management skill and the like. In fact, in the absence of any provision of support provided to small firms, with different steak holds undoubtedly, this can be impact the growth and survival of small firms. In addition, SEDA is a government agency that aims to provide various training provision for small enterprises. However, as per the interviewee feedback the training provision of SEDA is limited small firms found relatively in big towns like Jimma. So, small firms relatively operating in small district still do not have access for training program regarding with financial management issues. Finally, the cumulative effects of what is mentioned above literary impact the financial management practice of those small firms.
5.2 Conclusions

Based on the previous analysis and discussion sections of the findings the following conclusions have been made.

This study investigated the financial management practices of small firms in Sokoru District. The study focused on six specific variables of financial management of small firms such as financial reporting, financial planning, analysis and control, working capital management, financing, investment, and accounting information systems.

The findings revealed that, the fact that owners of small firms have no adequate financial management skills and further training, most small businesses surveyed do not engage in financial planning, analysis, and control; do not set short and long term financial objectives; do not analyze the trend in sales, cost and profit. So, as far as small firms have no plan most of them un able to compare their financial plan with their financial performances. Additionally, the fact that small firms don’t engaged in the analysis of their sales, costs, and profit small firms do not have an idea of how to increase sale, minimized costs, and maximizing profit.

The result under financial statement reports indicated that, a significant majority of owners of small firms do not prepare monthly financial statements because of lack of awareness and knowledge. Similarly, lack of follow up and inability to maintain qualified accountants also other factors. Given that, small firms do not easily determine their financial successes and failures periodically. Further, users do not get access to timely and adequate financial information for decision makings. These negatively impact the performance of small firms.

With regard to accounting information systems, due to lack of accounting knowledge of the owners most small firms do not maintain complete accounting records. So, in the absence of these facts it can conclude that small firms do not determine fairly their financial successes and failures. Again, the inability of small firms to make use of computerized accounting systems also act as an obstacle to the successful implementation of sound financial management practices.
Hence, the fact that small firms do not have the application of computer software it can be conclude that all most all the accounting practices of small firms still manual basis.

The results under working capital management are mixed. Most small firms maintain purchase books and sale on account. However, apart from these small businesses appears poor at managing their working capital – especially as a result of lack of awareness and enough knowledge in working capital management’s areas. These significantly impact the well being of their businesses. Though, small firms do not maintain strong inventory management the small firms do not keep correctly the relationship between sales and inventories. On the other hand, the majority of small firms undertake re-stoking when the stock is down. But, the fact that none of the small firms make use of economic order quantity it can be concluded that, economic order quantity model became irrelevant for small firms.

While owners of small firms do not have experiences and owners have entered a business field in which he or she has very little knowledge most small firms did not evaluate the validity of their investment project before starting up the business. So, small firms could not decide whether or not the investment project should be accepted or rejected. However, of small firms who made the feasibility of their business ahead of starting were used payback period. The dominance of the payback period method over other methods can be attributed to its simplicity, emphasis on liquidity, and response to external financing pressures. In fact, other methods could be difficult for owners of small firm’s because, many small firms have limited knowledge in financial management and accounting; as a result, these firms may not be able to make use of reliable estimates of future cash flows.

The results under capital structure decision revealed that, small firms use retained earnings as a major source of financing for their investment and looking for additional alternatives. This makes prove of the Peaking Order Theory of Myers (1984). In addition, small firms often do not have access to finance mainly because of high collateral requirement by lending institutions and high interest rates charges which some of the small firms do not have or un able to pay. So, undoubtedly, inadequate sources of finance can impact the performances of small firms.
The majority of the small firms have make use of cost-plus pricing strategy to price their products due to its simplicity and convenience as compared to other pricing strategy namely, target rate of return, value based, and competition based pricing strategies. In theory, various objectives are possible in business environments; however, for most small firms the main reason conducting the business is profit motive.

The interview results indicated that, no specific support was provided to small firms through informal or formal training programs in particular to the issues of financial managements. Due to the traditional accounting practice of small firms it is very difficult to control and managed the accounting records of small firms. Especially, the facts that owners involved in business line in which they have limited financial management knowledge they were becoming unprofitable. Lastly, as per the interview results made with the management of trade and industry office, in general the performances of financial management practices of small firms were poor.

Overall, it can be concluded that the financial management practices of small firms are very weak – especially in the areas of financial planning, analysis and control, working capital management’s, and investment decisions. So, time should be taken to build up and apply sound financial management practices that make sure the growth of small firms.
5.3 Recommendations

The following major recommendations were put forward in light of the above findings and conclusions.

- Since, small firms are the most dominant businesses in Ethiopia, organizations responsible for small firms in Ethiopia – especially SEDA better to provide various training services for owners of small firms with respect to areas of financial management.
- It is advisable that, owners of small firms try to maintain professional accountants in order to maintain complete accounting records.
- It is advisable that the websites of government agencies such as SEDA include information on how small firms can be engaged in financial management practices.
- In long-run, the government better create conducive environment for financial system of the country in order to mobilize funds effectively. So that, small firms can get access to finance so as to raise their investment funds.
- Since significant part of small business investment is in working capital, the owner of the small firms better to consider how to keep it circulating quickly and make sure that none is lying idle.
- The concerned bodies – especially Trade and Industry and Internal Revenue Bureaus better to follow the financial statements maintained by small firms.
- Owner-managers of small firms better to evaluate the validity of their investment before started operations. Similarly, it is advisable that, owner-managers better not to engage in business in which they have no adequate knowledge and information.
- It is advisable for small firms to engage in financial planning, analysis, and control so as to easily compare their financial plan and performances, and have an idea of how to maximizing profit by minimizing costs.
5.4 Suggestions for Future Studies

As it is already presented, this study is exploratory in nature that calls for further studies. So, the following areas were recommended for further researches.

- It would be better if further study that involves small firms in the whole country is carried out.

- This study focused on the financial management function only. However, the main functional areas of business is not only the financial management function but also constitute other areas such as marketing management, human resource management, strategic management, supply chain, operations management etc. These functions are interrelated and work together with one another during business operation. So, the fact that owner-managers of small firms have limited financial management practices could mean that their performances in the other functional areas can also be limited. So, given this fact, it would be better if further studies be conducted so as to include other functional areas of businesses which are mentioned above.
Bibliographies


Clodfelter, R., (2003). Retail buying from basics to fashion 2nd edition, USA.


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Dear Sir or Madam, this questionnaire is designed to conduct survey research on assessment of financial management practices of small businesses in Sokoru District (Sokoru town) to explore the performances of owners of small firms in practicing financial management; identify factors that deter the application of sound financial management of small firms.

In order to accomplish this study, I am requesting you to complete this questionnaire. In this regards, the information obtained will be used purely for only academic purposes and will therefore be treated with utmost confidentiality. Thus, please read each statement and indicate your level of agreement by taking from the options provided. If you make an error, cross it out and indicate your actual response.

**Part I: Questionnaires prepared for the owners of small firms**

**Section I: Biographical Information**

Please kindly tick (✓) your answer in the appropriate boxes or respond by writing if required.

1. Sex: Male    Female

2. Types of the firm:

   Merchandizing  Manufacturing  Service

3. Number of employees:

   1–5  6–10  11–15  16–20

4. Level of Education:

   Primary  Secondary  Diploma  Degree and above
Section II: Issues related to the specific areas of Financial Management

5 Financial Planning, Analysis, and Control

<table>
<thead>
<tr>
<th>Financial Planning, Analysis, and Control practices</th>
<th>Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do you:</td>
<td>Never</td>
</tr>
<tr>
<td>Set short-term financial objectives?</td>
<td></td>
</tr>
<tr>
<td>Set long-term financial objectives?</td>
<td></td>
</tr>
<tr>
<td>Compare financial plans with your performances?</td>
<td></td>
</tr>
<tr>
<td>Analyze the trend of your sales?</td>
<td></td>
</tr>
<tr>
<td>Analyze the trend of your cost?</td>
<td></td>
</tr>
<tr>
<td>Analyze the trends of your profit?</td>
<td></td>
</tr>
</tbody>
</table>

6 If 'never' for question 5 above would you specify the limiting factors to maintain financial planning, financial control, and financial analysis?

7. Do you prepare financial statements like Income statement, Balance sheet, and Statement of owner’s equally?
   Yes            No

8. If 'no' to question 7 above, what are the key factors that hinder you preparing those financial statements?
   Lack of knowledge about financial statements
   It is not necessary for small firms
   Qualified accountants are expensive to maintain
   No follow up
   Others if any, please specify ________________________________

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9. Accounting Information Systems

<table>
<thead>
<tr>
<th>Accounting information practices</th>
<th>Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do you:</td>
<td></td>
</tr>
<tr>
<td>Keep Sales books?</td>
<td></td>
</tr>
<tr>
<td>Keep Purchases Books?</td>
<td></td>
</tr>
<tr>
<td>Keep Expenses Books?</td>
<td></td>
</tr>
<tr>
<td>Make drawings from your business?</td>
<td></td>
</tr>
<tr>
<td>Record your drawings?</td>
<td></td>
</tr>
<tr>
<td>Maintain a record for fixed asset?</td>
<td></td>
</tr>
<tr>
<td>Keep a stock book?</td>
<td></td>
</tr>
<tr>
<td>Keep a cash book?</td>
<td></td>
</tr>
<tr>
<td>Have a debtor’s book?</td>
<td></td>
</tr>
<tr>
<td>Keep a creditor’s book?</td>
<td></td>
</tr>
<tr>
<td>Have a computer for record?</td>
<td></td>
</tr>
<tr>
<td>Make any provision for depreciation?</td>
<td></td>
</tr>
</tbody>
</table>

10. If ‘no’ to question 9 above, would you mention below why you fail to do so?

11. Working Capital management

<table>
<thead>
<tr>
<th>Working capital management practices</th>
<th>Response</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do you:</td>
<td></td>
</tr>
<tr>
<td>Prepare a cash budget?</td>
<td></td>
</tr>
<tr>
<td>Sell on account?</td>
<td></td>
</tr>
<tr>
<td>Purchase on accounts?</td>
<td></td>
</tr>
<tr>
<td>Deposit your money daily in a bank account?</td>
<td></td>
</tr>
<tr>
<td>Determine an average days between the collections and repayments?</td>
<td></td>
</tr>
</tbody>
</table>

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12. If ‘no’ for question 11 above, would you state the reasons?

13. How often do you take an inventory?
   - Daily
   - Monthly
   - Annually
   - Don’t take an inventory

14. How do you decide for your re-stock?
   - Periodically
   - Based on Projected sales
   - When stock is down
   - Based on consumer demand

15. Did you evaluate the feasibility of your business before starting? (capital budgeting)
   - Yes
   - No

16. If ‘no’ to question 15 above, would you mention the reasons?

17. If ‘yes’ to question 15 above, which capital budgeting techniques you frequently used?
   - Payback
   - Accounting rate of return
   - Rate of
   - Net present value
   - Post Pay-back
   - Profitability

18. What is the source of your financing? (Capital Structure)
   - Loan from Banks
   - Loan from Micro finances
   - Loans from relatives and families
   - Retained earnings
   - Others

19. Do you compare your debt and equity?  Yes  No

20. If ‘no” to question 19 above, the reason is;
   - Lack of awareness
   - Not important for small firms
   - It takes time
   - No appointed professional to the areas
   - Others
21. What are the most influencing problems you currently facing with regard to financing
decision?
High collateral is required
High interest rate
Other variables

22. What kind of pricing strategies you are using in your business?
Cost-plus method Target return method
Value based pricing Completion based pricing
Others

23. What is the goal of your firm?
Profit maximization Wealth maximization
Customer satisfaction To have large market share

Thank you!!
Part II: Structured Interviews prepared for Management of Trade and Industry Office of Sokoru District.

The following interview questionnaires were adopted to obtain information from Sokoru Trade and Industry office to support data obtained from owners of small firms.

1. Did your office provide various training program for small firms in order to improve their financial management’s performances? If not, why?

2. Is there any supervision and follow up to ensure weather small business firms maintain proper financial records or not? If not, why?

3. What are the most pressing problems that currently facing with small firms with regard to financial management issues?

4. Do you take any measure to address those problems observed in areas of financial management of small firms? If not, why?

5. Overall, what can you say about performances of small firms in Sokoru Town especially in their financial management areas?

Thank you!!