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# Financial Management Practices In Small And Medium Enterprises in Selected Districts In Western Uganda.

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**Abstract**
This study was done to determine the extent of financial management practices in Small and Medium Enterprises(SMEs) in selected districts in Western Uganda. The objectives of the study were; to determine the extent of financial management employed by SMEs as to these dimensions:working capital management (cash management, accounts receivable management, inventory management practices), investment, financing, financial reporting and analysis and accounting information systems;The study used ex-post facto or retrospective and prospective designs together with descriptive design and descriptive comparative as well as correlation design. 335 questionnaires were distributed to respondents and were the ones used for analysis. The study found out that majority of SMEs owners (52%) in western Uganda are female, more than 69% of the SMEs owners are in their early adult hood and majority of the SMEs owners are high school leavers (30.1%), over 50% of the SMEs are sole proprietorship businesses and majority of the SMEs (42.4% have been in business between1-4 years. The findings further revealed that the extent of financial management is low among SMEs (Average Mean = 2.19). The Theory of Pecking Order (Myers 1984) which states that Management has a preference to choose internal financing before external financing, was proven in this study in the aspects of SMEs using internally generated funds as compared to borrowed funds. The recommendations from the study included; the Ministry of Finance and Economic Planning, Bank of Uganda should provide a favourable platform for SMEs to access financing that can enable them to run their businesses at a reasonable cost of financing. ICPAU, ACCA Uganda, URA should sensitize the SMEs owners on the relevance of bookkeeping, financial reporting and analysis as well maintaining proper books of analysis.
**Key Words:** Financial Management, Small and Medium Enterprises (SMEs)

## 1. Introduction

Small and Medium Enterprises (SMEs) contribute greatly to the economies of all countries, regardless of their level of development. About 80% of the labour force in Japan and 50% of workers in Germany are employed in the SME sector. With respect to developing countries and according to the ILO/JASPA (1998), the sector made a significant contribution to the gross domestic product of Uganda (20%), Kenya (19.5%) and Nigeria (24.5%).

The term SMEs covers a wide range of perceptions and measures, varying from country to country and between the sources reporting SME statistics. Some of the commonly used criterions are the number of employees, total net assets, sales and investment level. However, the most common definitional basis used is employment, but, there is a variation in defining the upper and lower size limit of an SME (Ayyagari, Beck & Demirguc-Kunt, 2003).

The Ugandan economy has made significant recovery since 1987, and is on the way to sustainable growth and development. This is being made possible by prudent policies that have been consistently pursued for the last 15 years towards economy liberalization and support for the private sector. It is estimated that there are about 1,069,848 micro and small-scale enterprises in Uganda, the majority of which are located in rural areas and on the outskirts of urban areas, producing goods and services consumed not only by the low-income class but also by some sections of the middle class. As in most developing countries, small and medium-scale enterprises form a significant part of the Ugandan economy. Nevertheless, they face a number of problems, including access to finance from formal sources, which is often considered to be the most important problem (MFPED 2008).

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Recent evidence shows that Small and Medium Enterprises (SMEs) form the bulk of Uganda's private sector. If Uganda is to become competitive through growth of the private sector, it is inevitable that more attention must be paid to addressing the key bottlenecks to SME growth and competitiveness (MFPED 2008). Access to, and costs of finance are reported to be a severe problem for SMEs in Africa. Good financial management practices have been viewed as critical elements in the success of SMEs in Uganda.

Though SMEs are making positive contributions to economic growth and development in Uganda the rate of failure is also high (Kazooba, 2006). Meredith (1986) asserts that 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. However, such areas are not currently well embraced by SMEs in Uganda and urgent attention needs to be paid to.

Lack of effective management during SMEs early stages is also a major cause of business failure for small businesses. Owners tend to manage these businesses themselves as a measure of reducing operational costs. This study uncovered the example of business person who locks the shop for a full day whenever he goes shopping in Kampala. He does this once every week, a total of four days a month. One result of this is loss of customer loyalty. This is clearly explained by Katuntu's remarks that poor location of business, lack of management experience, and over-investment in fixed assets has led to the collapse of many businesses (Kazooba 2006). Inefficient financial management may damage business efficiency and this will continuously affect the growth of the Small and Medium enterprises. However, efficient financial management is likely to help SMEs to strengthen their business efficiency and, as a result, these difficulties can partly be overcome.

Kazooba (2006), argues that though Uganda is among the countries with high start up of SMEs, it also has the highest numbers of non performing SMEs as well high number of closure of SMEs. However, the studies conducted did not show how the components of financial management affects the over all business efficiency of SMEs. A large number of business failures have been attributed to inability of financial managers to plan and control properly the current assets and current liabilities of their respective firms (Mbaguta, 2002). However, to date the studies done on financial management practices in SMEs in Uganda are scanty and thus called for this study on financial management practices in SMEs in selected districts in Western Uganda.

## 2. Literature Review

### 2.1 Financial Management

Financial management is one of several functional areas of management but it is central to the success of any small business (Meredith, 1986). Financial management is the management of finances of a business in order to achieve the financial objectives of the business. McMahon et al. (1993) defines financial management based on mobilizing and using sources of funds: Financial management is concerned with raising the funds needed to finance the enterprise's assets and activities, the allocation of theses scare funds between competing uses, and with ensuring that the funds are used effectively and efficiently in achieving the enterprise's goal.

Financial management as used in this study is composed of five (5) constucts and these include; working capital management which is also subdivided into cash management, receievables management and inventory management. Other constructs under financial management include; investment, financing, accounting information systems and financial reporting and analysis.

Ross et al (1999) indicated three kinds of decisions the financial manager of a firm must make in business; these include the financing decision, and decisions involving short-term finance and concerned with the net working capital, investment and financial reporting. Similarly, Ang (1992) also indicated three main financial decisions including the investment decisions, financing decisions and dividend decisions.

The strong points of financial management practices in the SME sector have long attracted the attention of researchers. Depending on different objectives, researchers emphasize different aspects of financial management practices. McMahon, Holmes, Hutchinson and Forsaith (1993) and McMahon (1993) summarize their review of financial management practices in Australia, the UK and the USA. In their review the context of financial management practices includes the following areas: accounting information systems, financing decisions, investing decisions. However, these previous researchers though looked into financial management, they did not include other key areas like working capital management which would include accounts recievable, inventory, cash management and accounts payable management.

 

### 2.1.1 Working Capital Management

Previous researchers emphasized specific aspects of working capital management. Burns and Walker (1991) examined working capital management as a whole. In their survey of working capital policy among small manufacturing firms in the USA, the following aspects of working capital were considered: working capital policy, managing working capital components, including cash, receivable, payable and inventory management, and relationships between working capital management practices and and profitability without clearly handling other aspects of business efiiciency.

Cash management practices among SMEs was found to be inadequate in the study done by Grablowsky (1978) and Grablowsky and Lowell (1980) conducted a questionnaire survey concerned with the cash management practices of 66 small enterprises from a number of industries located in and around Norfolk, Virginia. The results showed that 67 percent of respondents replied they did not do forecasting of cash flows. When asked how they determined the level of cash to be held by the business, less than 10 percent of enterprises reported using any type of quantitative technique. Additionally, seventy-one percent of business in the Virginia survey reported that they had no short-term surpluses of cash in their recent history. Only 23 percent had a long-term surplus. Nearly 30 percent of respondents had invested excess cash in earnings securities or accounts. The most common investments were savings accounts, certificates of deposit, treasury bills, repurchase agreements, commercial papers, shares, bonds and other investments.

In the study condected by Cooley and Pullen (1979), cash management was seen as the process of planning and controlling cash flows. It consisted of three basic components: cash forecasting practices, cash surplus investment practices and cash control practices. Cooley and Pullen (1979) examined cash management practices of 122 small businesses engaged in petroleum marketing and reported that 73 percent of respondents had experienced a cash surplus. In a divergent view to Grablowsky and Rowell's (1978) and Cooley and Pullen's (1979) survey, Murphy's (1979) study indicated that active cash management in small enterprises in the UK was unusual, and that there was little inclination to invest surplus cash on a short-term basis.

Regarding accounts receivable management practices, Grablowsky (1976) and Rablowsky and Lowell (1980) found generally low standards. Approximately 95 percent of businesses that sold on credit tended to sell to anyone who wished to buy. Only 30 percent of respondents subscribed to a regular credit reporting service. Most had no credit checking procedures and guidelines, and only 52 percent enforced a late-payment charge. Thirty-four percent of businesses had no formal procedure for aging accounts receivable. Bad debts averaged 1.75 percent of sales, with a high of 10 percent in some concerns. Murphy (1978) revealed a very high level of awareness and utilization of credit control systems in the UK, even in the smallest businesses.

The previous studies done on inventory management practices, D'Amboise and Gasse (1980) studied the utilization of management techniques in small shoe and plastic manufacturing industries in Canada and found 64 percent of shoe and 65.4 percent of plastic businesses employed formal inventory control systems. While Grablowsky and Rowell (1980) found that most of the respondents had in excess of 30 percent of their capital invested in inventory, the general standard of inventory management was poor. Only six percent of businesses in their survey used a quantitative technique such as economic order quantity for optimizing inventory and 54 percent had systems which were unable to provide information on inventory turnover, reorder points, ordering costs or carrying costs. Related to the methods used to determine inventory level, Grablowsky (1984) compared methods used by a sample of 94 small enterprises with those used by large enterprises and found that large enterprises used methods to determine inventory levels far more than small enterprises.

### 2.1.2 Investment

Brigham (1995) 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. Capital budgeting has attracted researchers over the past several decades. McMahon et al. (1993) claimed the earliest study of capital budgeting of SMEs was reported by Soldofsky (1964). During 1961, Soldofsky interviewed 126 owners of small manufacturing businesses in Iowa and the results were published in 1964.

Regarding capital project selection techniques, there were several surveys conducted by previous researchers such as Soldofsky (1964), Luoma (1967), Taylor Nelson Investment Services (1970), Hankinson (1979), Grablowsky and Burns (1980), Proctor and Canada (1992), and Block (1997). Soldofsky's (1964) study results shows around 58 percent of respondents used payback period methods whereas only 4.1 percent employed accounting rate of return technique.

 

Block's (1997) survey of 232 small businesses in the USA indicated payback method remains the dominant method of investment selection for small businesses, whereas large corporations widely incorporate discounted cash flow models in financial analysis of capital investment proposals (Proctor and Canada, 1992). This is not evidence of a lack of sophistication as much as it is a reflection of financial pressures put on the small business owner by financial institutions.

Payback period was used to evaluate capital projects by 51 percent of respondents, while 30 percent reported use of some variation of accounting rate of return. Only 10 percent reported use of discount cash flow methods such as net present value (5 percent) and internal rate of return (2 percent). This finding is consistent with the Soldofsky (1964), Louma (1967), Corner (1967), and Grablowsky and Burns (1980) findings of a tendency in using simple and complicated methods of capital investment project evaluation.

**2.1.3 Financing**

Small companies frequently suffer from a particular financial problem of lack of a capital base. 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), modern capital structure theory began in 1958, when Modigliani and Miller's (1958) seminal article on capital structure was published. Since that point of time, researchers have attempted to explain how firms choose their capital structure. Myers (1984) stated: How do firms choose their capital structure? The answer is we don't know… we do not know how firms choose the debt, equity, or hybrid securities they issue.

This study was based on capital structure theory and Myers' Pecking Order Theory (1984). According to Myers (1984), the Pecking Order Theory (POT) 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 POT is that firms have no defined debt-to-value ratio. Management has a preference to choose internal financing before external financing. When a firm is forced to use external financing sources, managers select the least risky and demanding source first. When it is necessary to issue external sources, debt issuance is preferred to new equity.

In an attempt to explain small firm financing behaviour, other scholars have relied on agency theory. Agency theory holds that investors who have equity or debt in a firm require costs to monitor the investment of their funds by management or the small business owner (agency costs). This view suggests that financing is based on the owner-manager being able to assess these agency costs for each type of financing, and then select the lowest cost method of financing the firm's activities. One weakness of this explanation is that no one has yet been able to measure agency costs, even in large firms (Myers, 1984).

Barton and Gordon (1988) suggest that the following characteristics must be accounted for in any explanation of firm financing decisions: behavior at the firm level; fact that the capital structure decision is made in an open systems context by top management, and decisions reflects multiple objectives and environmental factors, not all of which are financial in nature. The firm's financing decision, then, appears to be a product of many internal and external factors, as well as managerial values and goals.

Thevaruban (2009) examined small scale industries and its financial problems in Sri Lanka. He underscored that SMEs of small scale industries in Sri Lanka finds it extremely difficult to get outside credit because the cash inflow and savings of the SMEs in the small scale sector is significantly low (Ganesan, 1982; 2000). Hence, bank and non bank financial institutions do not emphasise much on credit lending for the development of the SMEs in the small scale sector in Sri Lanka.

Pettit and Singer (1985) study underscored that financing is the most difficult problems of the SMEs in USA. External finance is more expensive than internal finance (Watson et al., 1998; Datta, 2010). Due to lack of access to external finance (private placements and initial public offerings of varying sizes), SMEs rely on bank loans as compared to their larger counterparts (Berger et al., 2001; Bracker et al., 2006).

Ssendaula (2002), lists factors that have discouraged banks from lending to SMEs. Among them are poorly compiled records and accounts; low levels of technical and management skills; outdated technologies; lack of professionalism and networking; lack of collateral; lack of market outlets due to poor quality and non-standardized products; poor linkages and limited knowledge of business opportunities. In addition, most businesses, such as those dealing in foodstuffs, have been affected by lack of proper storage facilities. This has been a major limitation on business success because most agricultural products require preservation and have an inelastic demand meaning that even if their prices are lowered, quantity demanded can increase in that same proportion to clear the market of surpluses.

 

**2.1.4 Accounting Information Systems**

D'Amboise and Gasse (1980) studied the utilization of formal management techniques in 25 small shoe manufacturers and 26 small plastic manufacturers in Quebec, Canada and found that 88 percent of the businesses used a cost accounting system. Regarding accounting standards, DeThomas and Fredenberger (1985), in a survey of over 360 small enterprises in Georgia, found that the standards of financial record keeping was very high. In addition to cheque and deposit receipts, around 92 percent of respondents had some form of record keeping. Regarding the use of financial information, DeThomas and Fredenberger's (1985) study indicated that 96 percent of the respondents had financial statements prepared, the responsibility for evaluating and using the information was within the business itself and only four percent relied on an outside accountant services.

In the survey of 69 small enterprises across the USA, Farhoodman and Hryck (1985) reported on the most important applications of computers, and it was found out that accounting was rated as the highest percentage. Similarly, Palmer (1994) interviewed 36 small independent retail owner-managers and found that 33 percent of the sample businesses used computerized accounting systems. Reviewing previous research results shows accounting and financial management applications dominated the use of computers in small and medium enterprises in the North America in 1980's and 1990's.

Williams (1986) evaluated the adequacy of accounting records for 10,570 failed and surviving small enterprises operating throughout Australia. The findings are compatible with Peacock's (1986, 1987,1988) findings in that a significant proportion of owner-managers kept inadequate accounting records. Holmes (1987) conducted a survey of accounting information requirements of 928 small enterprises operating in Sydney, Melbourne and Brisbane. Fifty-seven percent of respondents indicated they used the journal/ledger (double entry) systems. This finding is rather in contrast to Peacock's (1987) findings of types of records maintained by failed enterprises, where only 2.1 percent of respondents were found to use double entry systems.

**2.1.5 Financial reporting and analysis**

Bookkeeping alone without preparing reports is likely not to be fundamental in aiding decision making unless proper reports are prepaed and analyzed to attach a meaning so as to help decision makers. D'Amboise and Gasse (1980) studied the use of financial statement analysis by small manufacturers in Quebec, Canada and found that small manufacturers in shoe and plastic industries formally undertook the analyses based on financial statements and the findings revealed that manufacturing firms managerial decisions were largely based on the financial reports prepared.

The research conducted by DeThomas and Fredenberger (1985) found that 81 percent of the small enterprises regularly obtained summary financial information. Ninety-one percent of the summary information was in the form of traditional financial statements (balance sheets, profit and loss statements, fund statements), the remainder being bank reconciliation and operating summaries whereas no business was regularly receiving cash-flow information. The study further found that 61 percent of respondents felt the financial statements provided the information they required for planning and decision-making. Nevertheless, only 11 percent of respondents reported that they had used financial statement information formally as part of managerial evaluation, planning and decision-making, 2 percent of businesses utilized financial ratio analysis, and few made even simple historical comparisons.

Thomas and Evanson (1987) studied 398 small pharmacies (in Michigan, North Carolina, Nebraska, Rhode Island and Washington) to examine the extent to which financial ratios were used in a specific line of small retail business and tested for a relationship between use of financial ratios and business success. The study used regression analysis to examine the relationship between financial ratio usage and SMEs profitability. However, they could not demonstrate any significant relationship between earnings-to-sales and the number of financial ratios used by the owner in operational decision-making. When efforts were made to include the effects of other managerial practices and variations in business environments, no association between use of individual ratios and total earnings or total to sales was found.

**3. Methodology**

This study adopted ex-post facto or retrospective and prospective designs, descriptive design, descriptive comparative, and descriptive correlation strategies were used. Data was collected using standardized questionnaires. A sample size of 386 respondents was computed using Sloven's formula out of a total of 10,730 SMEs in selected districts in Western Uganda. The retrieved questionnaires were 335 representing a retrieval rate of 87%. Cronbach's Alpha coefficient test indicated that the questionnaires were reliable since the coefficient was above 0.5 ($\alpha$=0.903). Respondents were selected using purposive sampling, systematic random sampling and simple random sampling to arrive at the desired sample of the owners of SMEs in selected districts in Western Uganda. Frequency and

 

percentage distribution were computed and significant differences were determined with the computation of Analysis of Variance (ANOVA).

## 4. Findings

In this chapter, the answers to the specific objectives of this study are presented, analyzed statistically in tables and interpreted to elaborate on the findings based on the related literature and empirical studies.

### 4.1 Extent of Financial Management Practices employed by SMEs

Tables 1 to 5 displays the extent of financial management employed by SMEs measured quantitatively and interpreted qualitatively on the following dimensions; (1) working capital management (cash management, accounts receivable management and inventory management practices); (2) investment; (3) financing; (4) accounting information systems; (5) financial reporting and analysis. Tables 1A, 1B and 1C illustrate the data on the subcategories of the main construct on working capital management. Tables 2, 3, 4 and 5 reveal the numerical data on the other main constructs on the extent of financial management in the aspects of investment, financing, accounting information systems, financial reporting and analysis respectively.

**Table 1A: Extent of Financial Management (Cash Management Practices)**

Cash management practices were measured in various terms as reflected through a closed-ended questionnaire. The owners or representatives of the owners were requested to rate their businesses on the extent to which cash management was being practiced.

**Table 1A**
**Extent of Financial Management ( Working Capital Management In Terms of Cash Management Practices)**
**(Item Analysis)**
**n=335**

| Item | Mean | Interpretation | Rank |
|---|---|---|---|
| **Cash Management Practices** | | | |
| The business has a bank account | 3.50 | Very High | 1 |
| The business normally experiences cash shortage | 3.26 | Very High | 2 |
| The business sells goods or services by cash | 3.13 | High | 3 |
| The owner/manager is involved in preparation of the cash budget | 2.89 | High | 4 |
| Cash budget is helpful in decision making | 2.88 | High | 5 |
| The business sets the minimum cash balance based on owner's experience | 2.77 | High | 6 |
| The business has a set minimum cash balance | 2.70 | High | 7 |
| There is monthly reconciliation of cashbook with the bank | 2.50 | Low | 8 |
| Temporary cash surplus is invested in marketable securities | 2.42 | Low | 9 |
| The business reviews the cash budget | 2.24 | Low | 10 |
| The business prepares a cash budget | 2.09 | Low | 11 |
| The business has internal controls on cash | 2.06 | Low | 12 |
| There is separation of cashier personnel from accounting duties | 1.95 | Low | 13 |
| The business sets the minimum cash balance based on historical data | 1.82 | Low | 14 |
| The business normally experiences cash Surplus | 1.79 | Low | 15 |
| The business sets the minimum cash balance based on a theory | 1.73 | Very Low | 16 |
| The business uses computer assisted software in preparing a cash budget | 1.69 | Very Low | 17 |
| **Average Mean** | **2.44** | **Low** | |

**Source: Primary Data 2012**

**Legend**

| Mean Range | Response Mode | Interpretation |
|---|---|---|
| 3.26-4.00 | Strongly agree | Very High |
| 2.51-3.25 | Agree | High |
| 1.76-2.50 | Disagree | Low |
| 1.00-1.75 | Strongly Disagree | Very Low |

From Table 3A , the results indicate that cash management practices are very low among SMEs in Western Uganda. Owning bank accounts notwithstanding (Mean= 3.50), most of the businesses experience very high cash shortage (Mean=3.26) in their operations. Similarly, the findings revealed that few SMEs that have cash surplus, do not invest in marketable securities in order to generate more income and this practice hinders their growth which eventually leads to their failure as earlier studies indicated; (Berryman, 1983; Peacock, 1985) and Kazooba (2006). Similarly research in the United States reported that internal problems related to cash flow management and inadequate capital (Dodge et al, 1994) led to higher failure of SMEs.

 

Notably, there are few SMEs that prepare cash budget (mean=2.09). This is a clear indication that cash is managed adhocly and for those that prepare the cash budget, the budgets are not reviewed regularly to match with the current operations (Mean=2.24). This is probably the major reason why a number of SMEs experience cash shortage as shown by the findings. It is also evident that minimum cash balance is not based on any theory (Mean= 1.73) and minimum cash balance is also not based on historical data that is as the business has been performing previously (Mean=1.82). The earlier researches conducted also showed that one of the most significant reasons behind the failure of SMEs is poor cash management and inadequate use of essential business and management practices (Kazooba, 2006).

**Table 1B: Extent of Financial Management (Working Capital In Terms of Accounts Receivable Management)**

The owners or representatives were requested to rate their businesses as far as management of accounts receivable is concerned. The ratings of the SMEs were analysed using means indicating the extent to which the SMEs used accounts receivable management as shown in Table 1B.

**Table 1B**
**Extent of Financial Management (Working Capital Management In Terms of Accounts Receivable Management)**
**(Item Analysis)**
**n = 335**

| Item | Mean | Interpretation | Rank |
|---|---|---|---|
| **Accounts Receivable Management** | | | |
| The business sells goods/services on credit | 2.96 | High | 1 |
| There is control over sales to employees | 2.66 | High | 2 |
| The sales are reconciled with inventory change | 2.65 | High | 3 |
| There is periodic preparation of aging schedule | 2.33 | Low | 4 |
| The business reviews the levels of percentage of bad debts | 2.32 | Low | 5 |
| There is control over collections of written-off recievables | 2.17 | Low | 6 |
| The business has a set credit policy in place | 2.15 | Low | 7 |
| The business applies the set credit policy while extending credit | 2.08 | Low | 8 |
| The business reviews the levels of recievables | 1.85 | Low | 9 |
| The business uses computer assisted software in managing receivables | 1.63 | Very Low | 10 |
| **Average Mean** | **2.28** | **Low** | |

**Source: Primary Data 2012**

**Legend**

| **Mean Range** | **Response Mode** | **Interpretation** |
|---|---|---|
| 3.26-4.00 | Strongly agree | Very High |
| 2.51-3.25 | Agree | High |
| 1.76-2.50 | Disagree | Low |
| 1.00-1.75 | Strongly Disagree | Very Low |

The findings from Table 1B, show clearly that the extent of accounts receivable management among SMEs is low (average mean = 2.28). Though the businesses offer goods to their customers on credit (mean = 2.96). It is important to note that trade credit is particularly important in the case of small and medium-sized companies, since trade debtors are the main asset on most of their firms' balance sheets (Giannetti, 2003). Similarly, Meltzer (1960) states that a primary function of trade credit is to mitigate customers' financial frictions, thus facilitating increased sales and market share growth (Nadiri, 1969). In addition to resolving financing frictions, trade credit can boost sales by alleviating informational asymmetry between suppliers and buyers in terms of product quality (Long et al., 1993, Smith, 1987).

The results from Table 1B showed that SMEs do not have a set credit policy in place to control the sales to be made on credit (mean = 2.15), this means that sales are just made to customers without vetting who should be granted credit and how much credit should be granted. This is further supported by the high levels of bad debts and the findings revealed that the levels of bad debts are not reviewed (mean = 2.32). This makes recovery of the money from credit sales difficult. Similarly, there is low control over write offs as far as bad debts are concerned (mean = 2.17) and this increases expenses in form of bad debts which reduces the profitability of the SMEs and thus affecting the overall going concern.

 

**Table 1C: Extent of Financial Management (Working Capital In Terms of Inventory Management)**

Worthwhile noting in Table 1C are the indicators under inventory management showing variations in the rating of the respondents from high to very low.

**Table 1C**
**Extent of Financial Management (Inventory Management Practices)**
**(Item Analysis)**
**n = 335)**

| Item | Mean | Interpretation | Rank |
|---|---|---|---|
| **Inventory Management Practices** | | | |
| There is physical safeguards of inventory against theft | 2.8 | High | **1** |
| Inventory levels are determined based on owner's experience | 2.76 | High | **2** |
| There is use of standard costs | 2.62 | High | **3** |
| There is periodic review of overhead rates | 2.52 | High | **4** |
| Periodic summaries of inventory usage are prepared and used | 2.31 | Low | **5** |
| There is proper authorization for purchases | 2.30 | Low | **6** |
| There is periodic inventory counts | 2.29 | Low | **7** |
| There is use of inventory requistions | 2.27 | Low | **8** |
| There is physical safeguards of inventory againstfire | 2.15 | Low | **9** |
| The business investigates discrepancies in inventory | 2.10 | Low | **10** |
| The business reviews inventory levels | 2.06 | Low | **11** |
| The business prepares inventory budget | 2.00 | Low | **12** |
| The business computes inventory turnover ratios | 1.90 | Low | **13** |
| The business uses Economic Order Quantity model in inventory management | 1.82 | Low | **14** |
| Inventory levels are determined based on historical data | 1.73 | Very Low | **15** |
| Inventory levels are determined based on the theory of inventory | 1.66 | Very Low | **16** |
| The business uses computer assisted software in recording inventory | 1.57 | Very Low | **17** |
| **Average Mean** | **2.17** | **Low** | |

**Source: Primary Data 2012**

**Legend**

| **Mean Range** | **Response Mode** | **Interpretation** |
|---|---|---|
| 3.26-4.00 | Strongly agree | Very High |
| 2.51-3.25 | Agree | High |
| 1.76-2.50 | Disagree | Low |
| 1.00-1.75 | Strongly Disagree | Very Low |

The findings in Table 1C revealed that inventory management practices among SMEs in Western Uganda is low (average mean= 2.17). The findings further revealed that there is no proper authorization of purchases among SMEs (mean = 2.30). This means that goods for resale are brought in as is and this affects the working capital of the businesses. The findings likewise revealed that there are low period inventory counts (mean = 2.29) indicating that stock taking is low among SMEs. Similarly, the results showed that there is low safeguards of inventory against fire (mean = 2.15) thereby putting the stock of the businesses at risk in case of fire break.

The results from Table 1C also showed that preparation of inventory budgets (mean = 2.00) among SMEs are very low indicating that the SMEs do not know the quantity of inventory to bring in and when to restock. This poses a big challenge since it ties up the working capital of the business. Also, the findings from Table 1C below revealed that computation of inventory turn over ratios are low (mean = 1.90), thus the linkage of inventory conversion into sales becomes unclear among SMEs. The findings are in agreement with previous scholars world wide like Kazooba (2006), where his findings indicated that there was almost none if not little management practices including inventory management among SMEs in Western Uganda, and Basil (2005), where his findings revealed that there were low levels of inventory management practices among SMEs.

 

**Extent of Financial Management (Investment)**

Evidently shown in Table 2 are the 9 indicators under the main construct on investment which also indicated ratings ranging from high to very low.

**Table 2**
**Extent of Financial Management (Investment)(Item Analysis)**
**n = 335**

| Item | Mean | Interpretation | Rank |
|---|---|---|---|
| **Investment** | | | |
| The business has cash for investment in long term projects | 2.70 | High | 1 |
| The business invests in non current assets | 2.54 | High | 2 |
| The business utilizes fully the non currents | 2.42 | Low | 3 |
| The business uses net present value to assess the investment | 2.34 | Low | 4 |
| The business uses Pay back period to assess the investment | 2.21 | Low | 5 |
| The business invests without evaluating the investment | 1.85 | Low | 6 |
| The business invests in real estate | 1.83 | Low | 7 |
| The business reviews the investment projects after a certain period | 1.81 | Low | 8 |
| The business invests in shares on the stock exchange | 1.74 | Very Low | 9 |
| **Average Mean** | **2.16** | **Low** | |

**Source: Primary Data 2012**

**Legend**

| **Mean Range** | **Response Mode** | **Interpretation** |
|---|---|---|
| 3.26-4.00 | Strongly agree | Very High |
| 2.51-3.25 | Agree | High |
| 1.76-2.50 | Disagree | Low |
| 1.00-1.75 | Strongly disagree | Very Low |

The findings revealed that few of the businesses have cash for investment in long term projects (mean = 2.7), these businesses vary from type and nature. Baldacchino (1995; 1999) highlighted that SMEs in small island states such as Fiji as compared to its counterparts lack the investment capital that can be permeated in the development of MSMEs.

Similarly, the findings from Table 2 showed that the SMEs invest in non current assets (mean = 2.54). However, the utilization of these non current assets is doubted, as the findings showed low and improper utilization (mean = 2.42). This has a big effect on the utilization in generating sales which affects the overall profitability of the businesses. Though some of the SMEs may have cash for investment, the majority of them invests without evaluating the investments (mean = 1.85). This puts the initial amount invested at stake as some of the businesses may not be viable. Few of the businesses use NPV (mean = 2.34) Louma (1967) conducted a survey of small and medium-sized manufacturing businesses in the United States and found that more than 22 percent of SMEs used formal methods of capital investment evaluation but none of them used NPV.

The findings from Table 2 further revealed that the investments made are not certainly reviewed after a certain period of time (Mean = 1.81). This means that if the investment goes bad on the way there is no way to know how to bring it back on track and thus losing the initial investment. Similarly few of the SMEs invest in real estate (mean = 1.83) and very few of SMEs invest in shares at the stock exchange (mean = 1.74). This clearly shows that the nearly convertible investments are not priority for investments for SMEs as earlier researchers stated like Brigham (1992) who 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.

**4.2 Extent of Financial Management (Financing)**

The third construct of financial management was financing practices among SMEs in Western Uganda. The owners of SMEs were requested to respond to various questions pertaining to financing on a Likert scale of four where 1 = strongly disagree, 2 = disagree, 3 = agree and 4 = strongly agree. The results are presented in Table 3 below.

 

**Table 3E**
**Extent of Financial Management (Financing)(Item Analysis)**
**n = 335**

| Item | Mean | Interpretation | Rank |
|---|---|---|---|
| **Financing** | | | |
| The business internally generated cash sources only | 2.88 | High | 1 |
| The business has easy access to bank loans | 2.40 | Low | 2 |
| The business uses internally generated cash and borrowed funds | 2.23 | Low | 3 |
| The business sets the capital structure based on the theory | 1.86 | Low | 4 |
| The business uses borrowed funds only | 1.73 | Very Low | 5 |
| **Average Mean** | **2.22** | **Low** | |

**Source: Primary Data 2012**

**Legend**

| **Mean Range** | **Response Mode** | **Interpretation** |
|---|---|---|
| 3.26-4.00 | Strongly agree | Very High |
| 2.51-3.25 | Agree | High |
| 1.76-2.50 | Disagree | Low |
| 1.00-1.75 | Strongly Disagree | Very Low |

The findings in Table 3E revealed that most of the SMEs are financing their businesses through internally generated funds (Mean = 2.88) and this is in agreement with the previous researchers like Kazooba (2006) who found out that most of SMEs use internally generated funds. McConnell and Pettit (1984) also found out that most of SMEs use internally generated funds. The results revealed that SMEs access to bank loans is low (Mean = 2.4). This is common among almost all SMEs and there are various reasons attributed, for example, lack of collateral security, poor record keeping to have statements supporting the SMEs to obtain loans from the banks. The findings are in agreement with previous researchers like Kazooba(2006) who found out that most of the SMEs in Mbarara had challenges in accessing finances which contributed much to business failure. Currie (2009) found out that the majority of SMEs in countries such as Ethiopia operate at under capacity due to lack of credit or over-regulation. This problem has been exacerbated by the demand for collateral by commercial banks as a prerequisite for the approval of loan applications.

The results in regard to the mode of financing SMEs, majority of them use internal financing as suggested by other previous scholars in the above paragraph. However,these findings are in disagreement with the studies conducted by Pettit and Singer (1985). SMEs rely on bank loans as compared to their larger counterparts (Huang and Brown, 1999; Chow and Fung, 2000; Berger et al., 2001; Bracker et al., 2006). According to Aguirrega biria (2007) and Buldyrev (2007), collateral is needed mostly due to the significant information gap that exists between potential lenders and borrowers.

The findings in table Table 3 further revealed that some of the businesses use a mixture of internally generated funds with external financing (Mean = 2.23). This is specially for some of the few SMEs who can somehow access credit from financial institutions. The findings further revealed that few of the SMEs set their capital structure based on theory (Mean = 1.86), thus there was nothing to base on whether the business should use internally generated sources or borrowed funds. The findings revealed also that very few of the SMEs use borrowed funds (Mean = 1.73) and this is attributed to many reasons as earlier mentioned. Most of the SMEs fear borrowing, due to the high costs associated with interest rates. SMEs also fear the bureacratic tendencies that must be followed in the banks in order to access bank loans. These findings stand to approve the Theory of Pecking Order as suggested by Myers (1984) which states that Management has a preference to choose internal financing before external financing.

**4.3 Extent of Financial Management (Financial Reporting and Analysis)**

The fourth construct of fnancial management was financial reporting and analysis practiced among SMEs in Western Uganda. The owners of SMEs were requested to respond to various questions partaining to financing on a Likert scale of four where 1 = strongly dis agree, 2 = disagree, 3 = agree and 4 = strongly agree. The results are presented in Table 4 below.

 

**Table 4**

**Extent of Financial Management (Financial Reporting and Analysis )**
**(Item Analysis)**
**n = 335)**

| Item | Mean | Interpretation | Rank |
|---|---|---|---|
| **Financial reporting and analysis** | | | |
| The manager/ owner is involved in preparing financial statements | 2.52 | **High** | 1 |
| The business prepares the income statement | 2.44 | **Low** | 2 |
| The business prepares the cash flow statement | 2.43 | **Low** | 3 |
| The business follows accounting principles | 2.38 | **Low** | 4 |
| The business prepares the balance sheet | 2.31 | **Low** | 5 |
| The business performs financial analysis | 2.27 | **Low** | 6 |
| The financial statements are prepared semi-annually | 2.13 | **Low** | 7 |
| The business prepares the statement of changes in equity | 2.11 | **Low** | 8 |
| The business regards the current financial reporting as adequate | 2.08 | **Low** | **9** |
| The financial statements are prepared annually | 1.96 | **Low** | 10 |
| The business uses profitability ratios | 1.93 | **Low** | 11 |
| The accountant is in charge of preparing financial statements | 1.89 | **Low** | 12 |
| The financial analysis is done using ratios | 1.88 | **Low** | 13 |
| The business uses liquidity ratios | 1.76 | **Low** | 14 |
| The business uses efficiency ratios | 1.75 | **Very Low** | **15** |
| The business uses leverage ratios | 1.74 | **Very Low** | **16** |
| **Average Mean** | 2.11 | **Low** | |

**Source: Primary Data 2012**

**Legend**

| **Mean Range** | **Response Mode** | **Interpretation** |
|---|---|---|
| 3.26-4.00 | Strongly Agree | Very High |
| 2.51-3.25 | Agree | High |
| 1.76-2.50 | Disagree | Low |
| 1.00-1.75 | Strongly Disagree | Very Low |

**4.4 Extent of Financial Management (Accounting Information System Usage)**

The fifth and final construct of financial management was Accounting Information System usage among SMEs in Western Uganda. The owners of SMEs were requested to respond to various questions pertaining to investment on a Likert scale of four where 1= strongly disagree, 2 = disagree, 3= agree and 4 = strongly agree. The results are presented in Table 5 below.

**Table 5**

**Extent of Financial Management (Accounting Information System Usage)**

**(Item Analysis)**

**n = 335)**

| Item | Mean | Interpretation | Rank |
|---|---|---|---|
| **Accounting Information System** | | | |
| The owner/manager is in charge of recording transactions | 2.97 | High | 1 |
| The business accounting system is informal | 2.65 | High | 2 |
| The business accounting system is formal | 2.04 | Low | 3 |
| The accounting department is properly staffed and operates efficiently | 1.97 | Low | 4 |
| The accountant is in charge of recording transactions | 1.93 | Low | 5 |
| The business uses computer assisted software in recording transactions | 1.59 | Low | 6 |
| **Average Mean** | **2.20** | **Low** | |

**Source: Primary Data 2012**

 

**Legend**

| Mean Range | Response Mode | Interpretation |
|---|---|---|
| 3.26-4.00 | Strongly Agree | Very High |
| 2.51-3.25 | Agree | High |
| 1.76-2.50 | Disagree | Low |
| 1.00-1.75 | Strongly Disagree | Very Low |

The findings from Table 5 revealed that most of the owners are in charge of recording transactions (Mean = 2.97). This is probably due to the fact that most of the SMEs are owned by sole traders who end up doing all the work themselves. The findings further revealed that most of the SMEs accounting systems are informal (Mean = 2.65). This is due to the fact that some of the SMEs may fear to maintain formal systems because they come with maintainance costs. The findings showed that the accounts departments are not functional and not efficiently operating which hinders financial reporting.

The results from Table 5 also revealed that few of the SMEs employ accountants and put them in charge of recording transactions (Mean = 1.93). This is associated with limited resources to enable SMES afford the services of professional accountants. Similary the findings revealed that use of computers and computer assisted softwares among SMEs is very low and this makes timely financial reporting as well as decision making very difficult. This is in agreement with the previous studies that have been carried out in the UK. The most significant studies of small enterprises were conducted by Bolton (1971).

Peacock's (1985, 1987, and 1988) findings revealed that few of the SMEs in South Africa were fully utilizing accounting information systems and that contributed to their failure. However, some other studies conducted in developed nations disagreed with the findings showing that most of the SMEs were mostly utilizing accounting information systems. D'Amboise and Gasse (1980) studied the utilization of formal management techniques in 25 small shoe manufacturers and 26 small plastic manufacturers in Quebec, Canada, and found that 88 percent of the businesses used accounting information systems.

## 5. Conclusion

Based on the findings of this study, the following conclusions were drawn:

The Theory of Pecking Order (Myers 1984) which states that Management has a preference to choose internal financing before external financing, was proven in this study in the aspects of SMEs using internally generated funds as compared to borrowed funds.

The study was able to bridge the gaps that were not covered by the previous studies since none of the studies had looked into financial management and business efficiency of SMEs in Uganda. The study brought up new knowledge on how SMEs apply financial management practices and the weaknesses that were found out in their current operations hindering their efficiency in terms of profitability and business growth.

## 6. Recommendations

ICPAU, PSFU, Enterprise Uganda, BUDS should provide a platform for training the SMEs owners on how to adopt and implement working capital management practices particularly on cash management since cash is the life blood of every business so as to ensure long term survival of the SMEs while current status of working capital management among SMEs in Western Uganda is low.

The SMEs owners should be advised to strengthen and put up policies regarding debtors on how to collect recievables, be able to know when to write off bad debts so as to minimize losses that accrue as a result of none payment. Similarly, efforts should be put by SME owners to ensure that inventory management is improved through setting re-order levels both for minimum and maximum so that the business does not run out of stock as well as not to tie too much capital in stock which affects the working capital.

The Ministry of Finance and Economic Planning, Bank of Uganda should provide a favourable platform for SMEs to access financing that can enable them to run their businesses at a reasonable cost of financing. This is necessary since the access to bank loans is difficult by SMEs and they end up using only internally generated funds. The interest rates should be favourable, similarly the requirements to accessing such funding should also be reasonable so as not to push SMEs away.

ICPAU, ACCA Uganda, URA should sensitize the SMEs owners on the relevance of bookkeeping, financial reporting and analysis as well maintaining proper books of analysis. Trainings should be organized for SMEs owners to help them

 

understand why they should keep updated books so as to know their levels of performance on whether they are making profits or losses as well as know how to control costs through looking at the previous data.

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