# THE EFFECT OF FINANCIAL MANAGEMENT PRACTICES ON THE FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES
## A CASE STUDY: PALLISA TOWN COUNCIL

**BY**

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**A RESEARCH REPORT SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE AWARD OF A DEGREE OF BACHELOR OF BUSINESS ADMINISTRATION, DEPARTMENT OF ECONOMICS AND MANAGEMENT, FACULTY OF MANAGEMENT SCIENCES, BUSITEMA UNIVERTY**

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## DECLARATION

I declare that this research report is my original work and has not been submitted for examination in this or any other university.

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# APPROVAL

This research report has been supervised and approved by me and was therefore ready for submission to the faculty of Business and Administration in Busitema University.

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Date: ………………………………………..

# DEDICATION

I dedicate this research to my dear friends who advised, supported and mentored me throughout my education up to university level. Above all, I thank the Almighty God for guidance and provision towards completion of this research.

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## LIST OF ABBREVIATION/ACRONYMS

| | |
|---|---|
| SMEs | Small and Medium Enterprises |
| KNBS | Kenya National Bureau of Statistics |
| EU | European Union |
| UK | United Kingdom |
| USA | United States of America |
| US | United States |
| GDP | Gross Domestic Product |
| FY | Financial Year |
| NPV | Net Present Value |
| IRR | Internal rate of Return |
| NSE | Nairobi Securities Exchange |
| ROA | Return on Equity |
| ROE | return on Equity |
| OLS | Ordinary Least Squares |
| I.CT | Information Communication Technology |
| SPSS | Statistical Package of Social Sciences |

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# ABSTRACT

The study examined the aspect of the financial management practices on the financial performance of small and medium enterprises in Pallisa Town Council. The objective of the study was to determine the effects of capital budgeting techniques on the financial performance of small and medium enterprises, to determine the effects of budgetary controls on the financial performance of small and medium enterprises and to determine the effects of financial leverage on the financial performance of small and medium enterprises. The study used a descriptive research design with a population of 45 SMEs and a sample of 40 was drawn from financial services, wholesale and retail shops, information communication and technology, agriculture and drug shops and a questionnaire was employed in the collection of data. However, the study aimed at finding out whether financial management practices has impact on the financial performance of small and medium enterprises a case study of Pallisa Town Council. The findings showed that there was a positive effect of capital budgeting techniques on the financial performance at ($r= 0.996$, $F=583.242$, $p<0.05$), budgetary control on the financial performance at ($r=0.994$, $F= 2747.198$, $p<0.05$) and investment monitoring on the financial performance at ($r=0.989$, $F=1342.382$, $p<0.05$). This therefore shows that there was a positive effect of financial management practices on the financial performance of small and medium enterprises in Pallisa Town Council. However, the study further recommends that a further study should be carried out to investigate the challenges facing successful implementation of financial management practices and the study also recommends further studies on organizations in other sectors of economy so as to enable generalization of the study findings.

# CHAPTER ONE:
# INTRODUCTION

## 1.1 Introduction

This chapter presents the background of the study, statement of the problem, general objective of the study, research objectives, research questions, scope of the study, significance of the study, assumptions, limitations, definition of terms, conceptual frame work and explanation of the variables.

## 1.1 Background of the study

Financial management was one of management functional areas which was core to success of business enterprises. Inefficient financial management, combined with the uncertainty of the business environment often led Business Enterprises to serious problems (Deresse and Prabhakara, 2012). The economic development of many countries has been established to depend primarily upon the establishment of small and medium enterprises thus making them a catalyst for economic development (Levy, 2015). However, improper financial management practices have proven to be a main cause of failures in SMEs in terms of financial difficulty, mismanagements of funds and shortage of long term funds to meet the operating cost and capital expenditure (Brigham and Ehrhardt, 2010).

In the global perspective, studies show that SMEs contribute over 55% of Gross Domestic Product (GDP) and over 65% of total employment in high-income countries such as Britain, USA, Canada and China (Asta and Zaneta, 2010). In middle-income countries, formal SMEs contribute about 20% more to employment and GDP than the informal enterprises. SMEs are an important source of export revenues in some developing economies. For example, SMEs contribute a larger share of manufactured exports in more industrialized East Asian economies (56% in Chinese Taipei, more than 40% in China) and in India (31.5%) compared to 1% in Tanzania and Malawi.

Further, SMEs are a major source of employment, generate significant domestic and export earnings, contribute to the general health and welfare of economies, and are a key instrument in poverty reduction (Mephokee, 2010). For instance, SMEs constitute 99.7 % and 99 % of all employers in the United States (US) and European Union (EU), respectively.

In Sub-Sahara Africa, Due to the role played by SMEs, African governments have put in place programmes to encourage growth of the sector through such interventions as creation of an enabling legal framework, access to markets, finance, training, capacity building and financial incentives among others (Eden, 2016). For example, in Nigeria, the overall regulatory framework for the SMEs was driven by specific SMEs acts which specify the key institutional linkages for effective coordination. Also in South Africa, SMEs constitutes about 91 percent of formal business entities, provide 61 percent employment and account for between 52 to 57 percent of South Africa's GDP (Abor and Quartey, 2010).

In Kenya, the SMEs have been of great benefit not only to the economy but also to the society at large. The sector employs over 4.6 million people which was over 30% of all employment and accounts for approximately 75% of all businesses. The sector also contributes 18.4% of the GDP and accounts for 87% of the new job creation (Kiveu, 2013). In Kenya, there are 1.56 million licensed SMEs and 5.85 million SMEs which are unlicensed. Manufacturing sector was yet to fully develop with the segment accounting for only 12% of all SMEs despite its potential in employment creation and absorbing enormous number of people (KNBS, 2016).

In Uganda, micro, small, and medium sized enterprises are the engine of growth for the economic development, innovation, and wealth creation of Uganda; they spread across all sectors with 49% in service sector, 33% in the commerce and trade, 10% in manufacturing and 8% in other fields. Over 2.5 million people are employed in this sector, where they account for approximately 90% of the entire private sector, generating over 80% of manufactured output that contributes 20% of the gross domestic product (GDP). According to the financial report of Pallisa Town Council, it revealed that in the annual budget report for FY (2018/19), there was poor performance of SMEs which putting the rate at 58% against the acceptable national standard of 80%. This could be associated to low profitability and low sales. The study was sought to be carried out in Pallisa Town Council.

## 1.2 Problem statement

Financial management practices have been recognized both in developing and developed countries on its importance in coordinating organization's functions enabling managers to understand the current financial position of the firm and capability in meeting future financial obligations (World Bank, 2014). This ensures that all the business transactions are undertaken in an orderly and well managed manner (Gormoma, 2014). Particularly, this was important to the SME sector where any mismatch in the financial practices was probable to negatively impact on the performance to a high extent.

However, the SMEs still continue to underperform despite their huge role in economic development due to a negative trend that was portrayed by poor financial performance associated with low profitability and low sales of the firm (Longenecker, 2010). This was evidenced by the annual budget report for performance of SMEs in the FY (2018/19) which put the rate of

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