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# Financial management practices and business performance of small and medium enterprises in western Uganda

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Small and medium Enterprises are seen as a driving force for the promotion of an economy. The purpose of the study was to establish the relationship between financial management practices and business performance of SMEs in western Uganda with a view to establishing a coherent model directed at improving business performance and it was hypothesized that financial management practices positively influences Business performance. The study adopted a positivist (quantitative paradigm) with cross sectional and correlational designs. The study used a respondent sample of 335 SMEs operating in Mbarara, Sheema and Bushenyi whose owners/managers were the unit of enquiry. Structural Equations Modeling with Analysis of Moment Structures were used to for statistical modeling. The findings in respect of the main purpose of the study indicated that financial management practices accounted for 33.8% of the variance in business performance of SMEs. The results also indicated that working capital management influences highly since it predicts over 22% of the variance in business performance. The present study supported a multi-theoretic approach in explaining business performance of SMEs in Uganda. The study supports the pecking order theory in explaining the financing of SMEs together with resource based view as the theories that help in explaining business performance of SMEs. The study confirmed efficient financial management practices factor structure of observed variables and the latent variables. As a result, the study provided models for efficient financial management practices. These models can then used to provide a trajectory for improving business performance of SMEs in Uganda. Policy makers, ICPAU, PSFU and SMEs owners may use these findings as a way of improving business performance of SMEs in Uganda since the SMEs are great contributors to the Ugandan economy. The owners of SMEs should develop a positive attitude towards adopting financial management practices so as to achieve desired business performance.

**Key words:** Financial Management, Business Performance, SMEs.

## INTRODUCTION

Small and medium Enterprises (SMEs) are seen as a driving force for the promotion of an economy (Khan and Jawaid, 2004) and they contribute immensely to the economic development of any country (Abor et al., 2010). In Uganda the SMEs sector contributes 20% to Gross Domestic Product and it provides employment to over 1.5

million people which accounts for 90% of total non-farming private sector workers (UIA, 2008). The benefits of the small and medium enterprises in Ugandan economy cannot be overemphasized. Small and medium enterprises play significant role in employment and income generation, producing import substituting

products, mitigating rural-urban drift and mobilization of local resources (Ernst and Young, 2011). Despite the significant contribution of small and medium enterprises to the Ugandan economy, the potentials of the SMEs have not been exploited fully and this is a concern of all stakeholders in the economy (UNCTAD, 2002; Ekanem, 2010; Tushabomwe-Kazooba, 2006). These very concerns are abounding elsewhere (Cookey, 2001; Ihembe, 2000; Ojaide, 1999). At the height of a number of initiatives undertaken by the government of Uganda aimed at improving and promoting the business environment, reduce the cost of compliance with business regulations, the reforms have not improved the situation as the performance of SMEs in Uganda is still below the expectation (UIA, 2008; Ernst and Young, 2011) and this possess a threat to the Ugandan economy since SMEs are great contributors to the GDP.

Some suggestions are advanced for the SMEs under-performance such as poor access to finances (Louis and Opondo, 2003) and generally lack of strategic resources consistent with the resource dependency theory propounded by Barney (1991). Indeed SMEs managed by owners with little knowledge (knowledge is considered a strategic resource) in business management (Grant, 1996) could suffer from this predicament. Barney's (1991) argument that firms could underperform due to inadequate resources could therefore be extended to SMEs financial performance. Moreover, extant studies (Degryse et al., 2011 and Raheman et al., 2007) explain performance trends in small and medium enterprises in Spain, Pakistan and identify efficient working capital as a major predictor of SMEs profitability and overall performance. Their findings are not at variance with Erasmus (2010) results that indicate that it is financing practices that determine the level of performance of SMEs. Other scholars like Nguyen (2001) share the same view and argue that efficient cash flow management practices enable SMEs to be profitable in Vietnam. However, other scholars like Abuzayed (2012) findings from his study on working capital management in Ghana, argue that cash management of SMEs depends on the mind set and experience of the owners.

Synthesizing existing studies in the broad area of explaining SMEs' performance indicates a clear dearth of studies examining multiplicative effect of various constructs of financial management practices like working capital management, financing, investing, financial reporting and analysis and accounting information system on performance of small and medium enterprises. More so, the studies done were not benchmarked on a theory that would explain performance of SMEs using individual predictors like working capital management. Nevertheless, literature on SMEs in Uganda (see for review Ernst and Young, 2011; Namatovu et al., 2010; Ishengoma and Kappel 2008; Tushabomwe-Kazooba, 2006; Louis and Opondo, 2003) is deficient of studies on financial management practices' predictive potential for business

performance of SMEs. Orobia et al. (2013) – who are a notable exception - show how SMEs owners manage working capital in Uganda and conclude that working capital management practices in Ugandan businesses are driven by the attitude and motivation of the individual and contextual factors. However, Orobia et al. (2013) study only provides a partial explanation as it ignores other financial management practices' constructs mentioned above. The current state of affairs of SMEs' financial performance might also stem from inadequacies in the theories applied. For example, contingency theory has been widely used in studies predicting performance and effectiveness of enterprises (Fiedler, 1964) and the theory argues that the most appropriate structure for an enterprise is one that greatly fits a given operating contingency, such as technology (Woodward, 1965) or environment (Burns and Stalker, 1961). As every company faces its own set of internal and external constraints it is not clear why financial management practices internal to the enterprise and augmented by owner-manager inherent resources have not been given due attention in a developing country context. Besides, Myers (1984) pecking order theory which states that firms have a preferred hierarchy for financing decisions. The highest preference is to use internal financing which includes retained profits before resorting to any form of external funds. Myers (1984) argues that internal funds incur no flotation costs and require no additional disclosure of proprietary financial information that could lead to more severe market discipline and a possible loss of competitive advantage. If a firm must use external funds, the preference is to use the following order of financing sources: debt, convertible securities, preferred stock, and common stock. However, Myers (1984) theory does not sufficiently stand to explain the behaviour of financing SMEs in developing countries due to the unique circumstances. Yet application of resource-based view sees firms to have a set of resources at its disposal which can be utilized by firms to maximize profitability (Barney, 1991). More so Knowledge-based theory as advanced by Grant (1996) identifies knowledge as an important resource which SMEs owner-mangers can use to boost their performance. Empirically, Degryse et al (2010) used pecking order theory and Alfo (2006) used agency theory in explain SMEs' performance, but the results do not assure that SMEs are predicted to improve performance. Failure to provide solutions to performance-related problems of SMEs will continue to hurt the Ugandan economy.

Thus this study employs resource-based view (Barney, 1991; Wernerfelt, 1984) since majority of the SMEs are owner managed and the owners are the providers of the resources to be used in business including finances. However, the resource based view ignores the knowledge aspect and since the SMEs are owner-managed, then the study considers the extent to which knowledge and skills of owners boost performance, thus calling for

the study to employ knowledge based theory. In addition, owing to dearth of studies examining multiplicative effect of various constructs of financial management practices, this study employs financial management practices as a multidimensional construct to provide a relevant trajectory for understanding financial performance of SMEs.

Profit maximization, business growth as components of business performance are still considered the major goals of business enterprises. Profits are desirable by the business to ensure a long term survival of the business and that's why there are many business start ups in Uganda. Whereas Uganda has the highest rate of business start-ups, it is also among the countries with the highest number of SMEs that perform poorly and close business before the end of the first year in business (Ernst and Young, 2011; Namatovu et al., 2010; Tushabomwe-Kazooba, 2006). This forms an area of concern to the owners of SMEs most especially if the attainment of such goals is constrained.

Poor business performance has for long remained unexplained most especially in the third-world countries perspective where the Small and Medium Enterprises occupy the large part of the economy. However, some studies from developed nations see (Nguyen, 2001) cite inefficient financial management practices to contribute immensely to SMEs poor business performance.

Thus financial management practices (working capital management, financing, investment, financial reporting and accounting information systems) which have been largely ignored among SMEs (Nguyen, 2001) since majority of the SMEs are individually owned, family owned may be advanced as a standing solution to the performance problems of SMEs in western Uganda. Previous studies which have studied SMEs among which Degryse et al. (2010), Alfo (2006) used agency theory and pecking order theory respectively. Moreover, the theories applied were inadequate in explaining business performance, thus requiring application of resource based view, and knowledge based theory as they point out resources in form of finances and knowledge as a requirement for understanding financial management practices to help curb the performance problems of SMEs. In Uganda the study conducted by Tushabomwe-Kazooba (2006), Lois and Annette (2005), found out that SMEs are not performing to the desired expectations and if this situation is not addressed, then the SMEs contribution to the Ugandan economy is likely to be affected.

Although previous studies showed a relationship between working capital management and profitability of SMEs and other related constructs, these studies are from the developed nations and had looked mostly at working capital management without looking deeply on the multiplicative effect of various constructs of financial management practices, that is working capital management, financing, investing, financial reporting and accounting information systems and how all these affect

business performance of SMEs; Almeida (2004), Degryse et al. (2010), Alfo (2006), Orobia et al., 2013 as an exception for Uganda. Whereas Orobia et al., 2013 studied how business owners manage working capital, the study employed action theory and the findings did not link working capital management to business performance of SMEs. More so these studies had unresolved contradictions together with theoretical limitations applicable to SMEs thus, calling for a new study in a developing country setting like Uganda to be done and help in establishing the relationship between financial management practices and business performance. Therefore, this study is important not because it fills the gap, but also it set out to address this gap of knowledge.

The purpose of the study was to establish the relationship between financial management practices and business performance of SMEs in western Uganda with a view of obtaining an appropriate model for improving business performance in western Uganda.

## LITERATURE REVIEW

### SMEs and financial management practices in Uganda

To date there is no universally accepted definition of small and medium enterprises (IFAC, 2011). The definition varies across countries and industries. In Uganda, Small and Medium Enterprises are officially defined on the basis of both the number of people employed and the annual turnover of the enterprise (Ernst and Young, 2011). Ministry of Finance, Planning and Economic Development defines a small enterprise as an enterprise employing a minimum of 5 people and a maximum of 50 people; and/or has an annual sales/revenue turnover of a maximum of Ugandan Shillings 360 million and total assets of a maximum of Ugandan Shillings 360 million, while a medium enterprise is defined as an enterprise employing between 50 and 100 people; and/or has an annual sales/revenue turnover of more than Ugandan Shillings 360 million and total assets of more than Ugandan Shillings 360 million (MFPED, 2008).

In Uganda the common terminology for SMEs is small business (Ernst and Young, 2011). The contribution of SMEs to Uganda economy cannot be over emphasized since SMEs contribute over 90% of total non-farm private sector employment, constitute approximately 20% of the national GDP, contribute over 20% of incomes of the labour force, and have great potential for reducing poverty levels (UIA, 2008).

Namatovu et al. (2010) observed that majority of the enterprises are found in restaurants and food processing, garages for motorcars and motorcycles, retail and whole sale trade, metal fabrication, furniture assembling, schools and transport services. Given the nature of the enterprises commonly operating in Uganda and the environment they are operating in, they are bound to face

a number of challenges (Ernst and Young, 2011). Majority of the SMEs do not prepare formal books of accounts, do not embrace information technology and are faced with challenges in accessing finance (Briggs, 2009). SMEs in Uganda operate in what is locally termed as “juakali” that is simply operating in a rudimentary way as noted by (UNCTAD, 2002). This is attributed to the environment in which SMEs are operating for example, customers do not ask for receipts whenever they purchase goods, similarly the suppliers do not ask for invoices either, private contracts are rarely documented and requirements for audited accounts are not enforced thus making it difficult for SMEs owners to record the initial transactions which eventually keeps SMEs with poor financial management practices (Ernst and Young, 2011). Financial management of SMEs came to limelight in Uganda in early 2000s. The conference on ways for managing finances of small and medium Enterprises took place on 30 April 2002 at the International Conference Centre in Kampala, Uganda with attendance of about 260 participants (UNCTAD, 2002).

Financial management of SMEs came to limelight in Uganda in early 2000s. The conference on ways for managing finances of small and medium Enterprises took place on 30 April 2002 at the International Conference Centre in Kampala, Uganda with attendance of about 260 participants (UNCTAD, 2002).

Most small and medium enterprise owners in Uganda consider financial management as an issue relevant only to large companies (Wanjohi et al, 2010). Financial management for SMEs has only become popular in Uganda in the early 2000 and to date there is scanty research on financial management practices for SMEs (Ernst and Young, 2011). Moreover, SMEs in Uganda are characterized by inability to maintain books of accounts, lack of proper internal control systems and lack of qualified persons (Ernst and Young, 2011).

The relative importance of the SME sector varies greatly across countries, whereby SMEs have been known to make important economic contributions, whether in developed or developing countries (Duchin et al., 2010). McMahon et al. (1993) defines financial management based on mobilizing and using sources of funds. According to McMahon et al. (1993) financial management is concerned with raising the funds needed to finance the enterprise's assets and activities, the allocation of these scarce funds between competing uses, and with ensuring that the funds are used effectively and efficiently in achieving the enterprise's goal.

The study by Nguyen (2001) stressed that financial management is made of fixed assets management, capita structure management, financial planning, working capital management, financial reporting and accounting information system. However, according to Meredith (2003), 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.

According to Peel et al. (1996), financial management practices most particularly working capital management has a strong effect on the firms' profitability. The same view is shared by Padachi (2006) and insists that there is need for a tradeoff between receivables and holding inventory if the firm is to attain the required profits. However, businesses need to be cautioned that heavy investment in inventory ties up capital which in the end reduces firm' profitability.

Thus summing up all the views of the previous researchers together with the relevant theories of resource based view, knowledge theory and dynamic capabilities theory, financial management is conceptualized as working capital management practices, financing practices, investment practices, financial reporting practices and accounting information practices. A multiplicative effect of all the constructs of financial management would have a reasonable influence on SMEs profitability (Nguyen, 2001).

### **Financial management practices and business performance of SMEs**

The study reviews the relationships between financial management practices and business performance of SMEs. This is done basing on the literature by critically reviewing findings of the previous researchers. Unfortunately, these findings are not clear because most previous researchers only focus on examining and describing financial management practices and financial characteristics but do not focus on examining the impact of financial management practices on SME profitability. Concerned with the relationships between working capital management practices and SME profitability, Abdul Raheman et al. (2007) provide some relevant findings as follows: Profitable firms reviewed their working capital policies on monthly and quarterly bases; profitable firms used an ROI (return on investment) criterion in looking at changes in the management of certain working capital components; profitable firms always or sometimes take discounts on payables whereas aggressive firms and those with written working capital policies were net users of trade credit.

Some theoretical researchers do indicate the relationships between financial management and profitability. Filbeck et al. (2000) indicated the relationship between liquidity and profitability

The study done by Garcia-Teruel et al, (2007) entitled “effects of working capital management on SME profitability in Spain” found a significant negative association between working capital management and SME profitability. In variance to the findings of Garcia-Terel (2007), the results from the study conducted by Uyar (2009) indicate significant positive correlations between working capital components with firms performance in Malaysia.

According to Bhunia et al. (2012) liquidity has a significant impact on profitability. However, such studies in Uganda are scanty and more over, literature available in developed nations see (MacMahon, 1998, Nguyen, 2001, Peel et al., 1996) looked at individual constructs of financial management majorly like working capital management. Moreover, the present study looks at a multiplicative effect of various constructs of financial management on business performance of SMEs. Thus the following hypothesis is set.

Garcia-Teruel and Martinez-Solano (2007) investigated the effects of working capital management on the profitability of a sample of small and medium-sized Spanish firms. Their findings revealed that managers can create value by reducing their inventories and the number of days for which their accounts are outstanding. Moreover, shortening the cash conversion cycle may improve the business profitability.

Mathuva (2009) examined the influence of working capital management components on corporate profitability by using a sample of 30 firms listed on the Nairobi Stock Exchange (NSE) for the periods 1993 to 2008. The findings from his study revealed that there exists a highly significant negative relationship between the time it takes for firms to collect cash from their customers. The results also revealed that there exists a highly significant positive relationship between the period taken to convert inventories into sales (the inventory conversion period) and profitability, and there exists a highly significant positive relationship between the time it takes the firm to pay its creditors and profitability. The same results are not at variance with Uyar (2009) results which showed statistical significant between working capital and firm performance.

Moreover, Romano et al. (2000) as well as Chittenden et al. (1996) suggest that a complex mix of social, family, cultural and financial factors influence capital structure while Kotey (1999) stresses the entrepreneurial attitudes to risk and debt. This view is shared by Ernst and Young (2011) who found out that majority of SMEs in Uganda use internal sources of finance through family and personal savings. Collis (2002) reported a positive correlation between structure of accounting department and profitability of business. In Uganda, majority of the SMEs owners do not consider book keeping necessary (Lois and Annette, 2005). Whereas there are some SMEs that prepare reports, they keep incomplete records which do not give a clear picture of the financial position and profitability of the firm (Ernst and Young, 2011).

## METHODOLOGY

The study adopted a positivist (quantitative paradigm) with cross sectional and correlation designs. Correlation design was used to establish relationships between financial management practices and business performance of SMEs. Logical positivism quantitative designs were very helpful in data collection, analysis and presentation which also helped to test hypothetical deductive

generalizations. The study population consisted of 10,730 SMEs from where the sample size of 335 SMEs were determined cluster sampling, simple random sampling techniques were used. Primary and secondary data sources were used in the study. Structural Equations Modeling with Analysis of Moment Structures were used to for statistical modeling.

Cronbach's (1951) alpha was used to test the reliability of the instruments and the instruments were found to be reliable at 0.75. Content validity of the two instruments was ensured through use of valid concepts which measure the study variables. Content validity was used to ensure that the questionnaire was content valid. The content validity results were obtained and for all the constructs were above 0.7 as recommended by Sakaran (2000). The study used Means and standard deviations in order to summarize the results. The means were used because they show a summary of data and standard deviation clearly shows how well the means represent the data (Field, 2009). Hierarchical regression was used because of its capacity to indicate precisely what happens to the model as different predictor variables are introduced in the model fit.

## RESULTS AND DISCUSSION

Results showed that financial management practices among SMEs are defined in terms of the five observed variables, working capital management, financing, investing, and accounting information system and financial reporting and analysis Table 1. Working capital management observed variables are made of cash management, receivables management and inventory management.

The measurement model Figure 1 shows NFI of 0.921, which indicated strong convergent validity. The chi-square value of 98.5 which is significant at the 0.05 level. The p-value is 0.024 suggesting that the model fitted the data acceptably in our population. Other fit indices included TLI = 0.914, GFI = 0.916, AGFI = 0.901 and RMSEA = 0.03. The p-values are significant (< 0.001). The observed factor loadings compared with their standard errors revealed evidence of an association between efficient financial management practices constructs among SMEs in Uganda.

The confirmatory factor analysis Table 2 and 3 showed that a five-factor conceptualization fitted the data appropriately (GFI = 0.953, RMSEA = 0.014, NFI = 0.960, Chi-Square = 14.7, *df* = 5, *p* = 0.012, TLI = 0.945, and AGFI = 0.860). Figure 2 shows financial management practices model which shows a strong convergent validity.

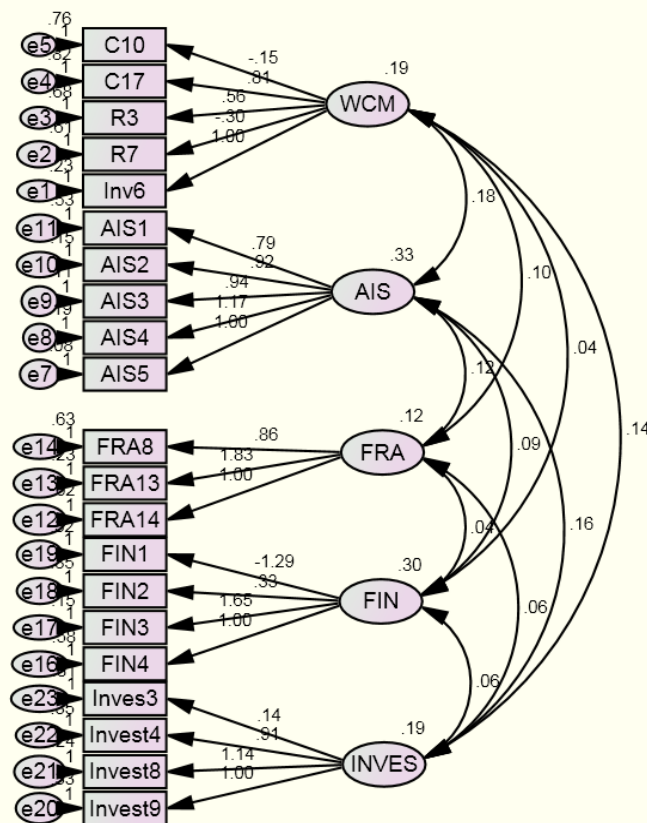
The findings revealed that standardized regression weights for working capital management, financing, investment, financial reporting and accounting information system Table 4, in explanation of financial management practices were significant (*p* < 0.001). The findings further revealed a strong relationship between financial management practices and business performance among SMEs in Uganda and Zero order was applied to determine the correlation between financial management practices and business performance (Table 5).

Results clearly shows that there is a positive and significant relationship between working capital management

**Table 1.** Financial management practices among SMEs.

Variables	N	Minimum	Maximum	Mean		Std. Deviation	Variance
				Statistic	Std. Error		
Investment	335	1.00	3.56	2.1619	.02404	.43998	.194
Accounting Information System	335	1.17	3.67	2.1915	.02001	.36621	.134
Financing	335	1.40	3.00	2.2233	.01882	.34441	.119
Working Capital Mgt	335	1.37	3.44	2.3477	.01629	.29816	.089
Business Performance	335	2.03	3.83	2.6913	.01535	.28092	.079

Source: Primary Data 2013.



Financial Management Practices Model for SMEs in Uganda  
 Chi-square = 98.5, df = 22, p = 0.001, RMSEA = 0.03, GFI = 0.916,  
 AGFI = 0.901, RMR = 0.096, CFI = 0.954, NFI = 0.921, TLI = 0.914  
 WCM = Working Capital Management  
 FIN = Financing  
 FRA = Financial Reporting and Analysis  
 AIS = Accounting Information System  
 INVES = Investment

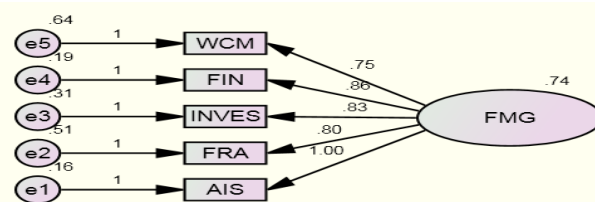
**Figure 1.** The measurement model.

**Table 2.** The confirmatory factor analysis.

Model	df	$\chi^2$	p	NFI	TLI	GFI	AGFI	RMSEA
Five-factor CFA model (WCM)	1	.042	.526	.999	.996	.998	.999	.003
Five-factor CFA model (AIS)	1	.035	.531	.998	.998	.998	.999	.003
Five-factor CFA model (Financing)	1	.018	.584	.998	.962	.996	.999	.003
Five-factor CFA model (FRA)	1	.016	.621	.953	.981	.994	.996	.003
Five-factor CFA model (Investment)	1	.025	.588	.942	.916	.948	.995	.003
Overall Five-factor CFA	1	.212	.517	.921	.914	.916	.916	.003

**Table 3.** The confirmatory factor analysis.

		Estimate	S.E.	C.R.	P	R <sup>2</sup>
Inv6	<--- WCM	1.000				
R7	<--- WCM	.992	.120	10.525	***	.723
R3	<--- WCM	.964	.130	9.343	***	.643
C17	<--- WCM	.906	.172	8689	***	.531
C10	<--- WCM	.954	.128	9.203	***	.620
AIS5	<--- AIS	1.000			***	.611
AIS4	<--- AIS	1.172	.060	19.617	***	.712
AIS3	<--- AIS	.936	.042	22.114	***	.458
AIS2	<--- AIS	.918	.051	18.032	***	.638
AIS1	<--- AIS	.991	.079	10.048	***	.317
FRA14	<--- FRA	1.000				.726
FRA13	<--- FRA	1.830	.373	9.907	***	.475
FRA8	<--- FRA	.860	.191	7.505	***	.724
FIN4	<--- FIN	1.000				.714
FIN3	<--- FIN	1.649	.160	10.312	***	.924
FIN2	<--- FIN	.926	.069	5.730	***	.524
FIN1	<--- FIN	1.292	.124	6.415	***	.438
Invest9	<--- INVES	1.000				.520
Invest8	<--- INVES	1.144	.144	7.941	***	.514
Invest4	<--- INVES	.912	.124	7.341	***	.486
Inves3	<--- INVES	.144	.135	1.065	***	.578



CFA for Financial Management Practices  
 Chi-square = 14.7, df = 5, p = 0.012  
 GFI = 0.953, AGFI = 0.860, CFI = 0.973, NFI = 0.960, TLI = 0.945  
 RMSEA = 0.014

**Figure 2.** Confirmatory factory analysis for Financial Management Practices



**Table 4.** Standardized regression weights.

		Estimate	S.E.	C.R.	P	R <sup>2</sup>
AIS	<--- FMG	1.000				.908
FRA	<--- FMG	.796	.085	9.368	***	.693
INVES	<--- FMG	.826	.076	10.907	***	.787
FIN	<--- FMG	.859	.068	12.680	***	.864
WCM	<--- FMG	.753	.094	8.035	***	.629

**Table 5.** Correlation between financial management practices and business performance.

	Mean	Std. Deviation	WCM	FRA	Invest	Fina	AIS	Financial Management All constructs	BP
WCM	2.35	0.30	1						
FRA	2.10	0.49	.588	1					
Invest	2.16	0.44	.364	.357	1				
Fina	2.41	0.34	.059	.070	.031	1			
AIS	2.19	0.37	.534	.624	.315	.052	1		
Financial	2.20	0.28	.743	.815	.665	.174	.778	1	
Management All constructs	2.69	0.28	.471	.460	.289	.134	.509	.527	
BP									1

\*\*. Correlation is significant at the 0.01 level (2-tailed).

\*. Correlation is significant at the 0.05 level (2-tailed).

practices and business performance ( $r = 0.471$ ,  $p < 0.05$ ). This means that efficient management of working capital practices like cash management, receivables management and inventory management is highly associated with improved business performance among SMEs.

The findings show that there is a positive and significant correlation between financing practices and business performance ( $r = 0.134$ ,  $p < 0.05$ ). This shows that there is a moderate relationship between financing practices and business performance of SMEs. This implies that efficient financing practices are associated with high business performance levels. Results further show that there is a positive and significant relationship between investment practices and business performance ( $r = 0.289$ ,  $p < 0.05$ ). This implies that efficient investment practices like appraisal of investments with techniques like payback period, net present value; internal rate of return is highly associated with better business performance. The results indicated a positive and significant relationship between financial reporting practices and business performance ( $r = 0.460$ ,  $p < 0.05$ ). This implies that efficient financial reporting and analysis is highly associated with high business performance since the records will show how the business is performing. In regard to accounting information system, the findings shows that there is a positive and significant correlation between accounting information systems

practices and business performance ( $r = 0.509$ ,  $p < 0.05$ ). This shows that there is a strong relationship between accounting information practices and business performance of SMEs. This implies that efficient accounting information system practices are associated with high business performance levels.

It is evident that there is a positive and significant correlation between financial management practices and business performance ( $r = 0.527$ ,  $p < 0.05$ ). The multiplicative effect of all practices including working capital, financing, investing, financial reporting and accounting information system have a strong association with business performance. The correlation between financial management practices and business performance was as follows: working capital management  $r = 0.471$ ,  $p < 0.05$ ; financial reporting and analysis  $r = 0.460$ ,  $p < 0.05$ ; investment practices  $r = 0.289$ ,  $p < 0.05$ ; financing practices  $r = 0.134$ ,  $p < 0.05$ ; and accounting information system  $r = 0.509$ ,  $p < 0.05$ . Since all correlation coefficients were positive and significant it shows that all financial management practices were positively related to business performance. This implies that efficient financial management practices combined together are associated with high business performance levels among SMEs.

To test the predictive power of the study variables, from the hypothesized model  $Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + e$

Where Y is the Dependent Variable – Business Performance

$\alpha$  = Constant

X = representing the components of the Independent Variable- financial management practices;

$X_1$  = Working capital management

$X_2$  = Financing

$X_3$  = Investment

$X_4$  = Accounting information System

$X_5$  = Financial reporting and analysis

$\beta_{1-5}$  = Coefficients of beta

e = error term in ascertaining the influence of individual element on business performance, all the models were significant since the model fit was met, then the details are shown as follows;

Model1:  $Y = \alpha + \beta_1 X_1 + e$

$Y = 1.650 + 0.444X_1$

( $t=15.305$ ), ( $t=9.740$ ),  $R^2 = 0.222$ ,  $F = 94.87$ ,  $DW = 1.467$

Model2:  $Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + e$

$Y = 1.470 + 0.263X_1 + 0.276X_2$

( $t=14.018$ ), ( $t=5.190$ ), ( $t=6.693$ )  $R^2 = 0.314$ ,  $F = 76.07$ ,  $DW = 1.467$

Model 3  $Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + e$

$Y = 1.427 + 0.240X_1 + 0.265X_2 + 0.056X_3$

( $t=13.303$ ), ( $t=4.617$ ), ( $t=6.364$ ) ( $t=1.770$ )  $R^2 = 0.321$ ,  $F = 52.08$ ,  $DW = 1.467$

Model 4  $Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + e$

$Y = 1.474 + 0.202X_1 + 0.225X_2 + 0.047X_3 + 0.071X_4$

( $t=13.472$ ), ( $t=3.645$ ), ( $t=4.883$ ) ( $t=1.491$ ) ( $t=1.976$ )  $R^2 = 0.329$ ,  $F = 40.38$ ,  $DW = 1.467$

Model 5  $Y = \alpha + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + e$

$Y = 1.295 + 0.200X_1 + 0.224X_2 + 0.037X_3 + 0.068X_4 + 0.080X_5$

( $t=9.420$ ), ( $t=3.623$ ), ( $t=4.897$ ) ( $t=1.495$ ) ( $t=1.910$ ), ( $t=2.130$ )  $R^2 = 0.338$ ,  $F = 33.56$ ,  $DW = 1.467$

In Model 1, working capital management practices accounts for 22.2% of variance in business performance ( $F = 94.87$ ,  $P < .005$ ) and caused a statistically-significant non-standardized coefficient ( $B = 0.444$ ,  $P < 0.05$ ).

In Model 2, the introduction of financing practices in the equation yielded an extra effect 9.2% to the explanatory power of the model. This clearly implies that financing practices accounts for an additional 9.2% of the variance in business performance. This means that a unit change in financing leads to 9.2% increase in business performance ( $F=76.07$ ,  $p < 0.05$ ), and caused a statistically-significant coefficient ( $B = 0.276$ ,  $p < 0.05$ );

Results for Model 3 indicate that the introduction of investment practices in the equation yielded a low significant effect of 0.7% to the explanatory power of the model. This means that investment practices explained an additional 0.7% of the variance in business performance ( $F = 52.08$ ,  $P < 0.05$ ), and caused statistically low significant coefficient ( $B = 0.056$ ,  $p < 0.05$ ); These findings

indicate that investment practices influence business performance of SMEs but with minimal effect.

In Model 4, the introduction of financial reporting practices in the equation also yielded a less significant 0.8% to the explanatory power of the model. Thus financial reporting account for additional 0.8% of the variance in business performance ( $F = 40.38$ ,  $p < 0.05$ ) and lead to statistically less significant contribution in coefficient ( $B = 0.071$ ,  $p < 0.05$ ).

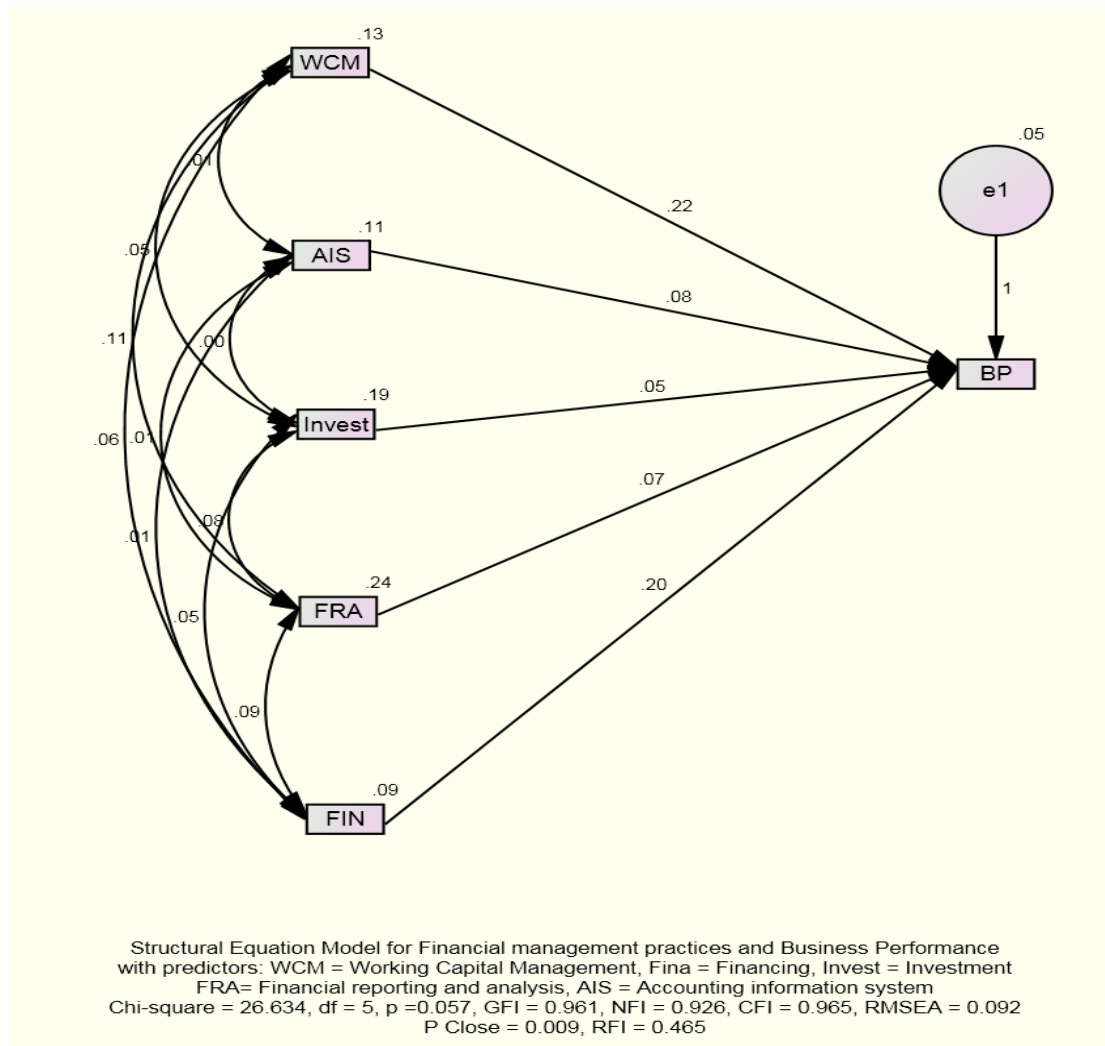
In Model 5, after the accounting information system was included, a less significant additional 0.9% was yielded and added to the explanatory power of the model. These results indicate that accounting information system account for only 0.9% of the variance in business performance ( $F = 33.56$ ,  $p < 0.05$ ), and caused a statistically less significant coefficient ( $B = 0.08$ ,  $p < 0.05$ ). However, model 5 shows the overall explanatory power of the model to be 33.8%. This clearly indicates that working capital management practices, financing practices, investment practices, financial reporting practices and accounting information systems when combined all together, predict up to 33.8% of the variance in the business performance of small and medium enterprises in western Uganda. Given, the unstandardized coefficients, financing practices has the highest beta followed by working capital management and then accounting information system, financial reporting and finally investment practices. Thus the order of predictive power needs to be given attention.

In order to obtain a clear view of the predictive power of financial management practices elements, further analysis was done using Structural Equation Modeling with the help of AMOS in order to establish the effect of the independent variable (financial management practices) on the dependent variable Figure 3 (business performance).

The estimate implies that one unit increase in the multiplicative effects of financial management practices leads to 33.9% positive variance in business performance. This path is significant ( $p < .001$ ) From the model details above, the SEM for financial management and business performance confirms the earlier results obtained using the multiple regressions where the predictive power of all the elements of financial management practices was 33.8%. As clearly seen from the squared estimate, the total effect of financial management practices on business performance represents 33.9%.

The findings in respect of the main purpose of this study indicated that in financial management practices accounted for 33.8% of the variance in business performance of SMEs. The results also indicated that working capital management influences is high since it predicts over 22% of the variance in business performance. The study accepted the hypothesis that financial management practices are positively related with business performance.

The present study supported a multi-theoretic approach



**Figure 3.** Structural Equation Model for Financial management practices and business performance with predictors: WCM=working capital management, Fina = Financing, Invest = Investment, FRA = Financial reporting and analysis, AIS = Accounting information system, Chi-square = 26.634, df =5, GFI = 0.961, NFI =0.926, CFI = 0.965, RMSEA = 0.092, P Close = 0.009, RFI = 0.465.

in explaining business performance of SMEs in Uganda. The study supports the pecking order theory in explaining the financing of SMEs together with resource based view as the theories that help in explaining business performance of SMEs. The study confirmed efficient financial management practices factor structure of observed variables and the latent variables. As a result, the study provided models for efficient financial management practices. These models can then used to provide a trajectory for improving business performance of SMEs in Uganda. Policy makers, ICPAU, PSFU and SMEs owners may use these findings as a way improving business performance of SMEs in Uganda since the SMEs are great contributors to the Ugandan economy. The owners of SMEs should develop a positive attitude towards adopting financial management practices so as to achieve desired business performance.

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