

FINANCIAL MANAGEMENT PRACTICES AND FINANCIAL PERFORMANCE OF SMALL AND MEDIUM ENTERPRISES IN PORT HARCOURT

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Abstract: The study examined the effects of financial management practices and financial performance of small and medium scale enterprises in Port Harcourt. The study adopted survey research design. Working capital management and capital budgeting are the dimensions of financial management practices while Return on Capital Employed was used to measure financial performance. The population of this study consist of 1225 registered small and medium enterprises in Port Harcourt. Sample size was determined using Taro Yemen. Purposive sampling technique was used to select the respondents at random. Structured questionnaire was used for data collection. The study made use of frequencies, simple percentages and mean score to analyse personal data of the respondents and other questionnaire items, while Pearson Product Moment Correlation was used to test the hypotheses formulated at 5% level of significance. The study found that: working capital management has a positive and significant relationship with return on capital employed of small and medium scale enterprises in Port Harcourt, capital budgeting has a positive and significant relationship with return on capital employed of small and medium scale enterprises in Port Harcourt. The study concluded that financial performance of small and medium scale enterprises in Port Harcourt has positively and significantly improved by financial management practices. The study recommended among others that small and medium scale enterprises should embrace financial literacy, financial information and financial management skills to effect optimal performance.

Keywords: financial management, financial performance, capital budgeting, return on capital employed, management

1. Introduction

Financial management practice comprises the processes, systems, internal controls and practices relating to the way the department manages its revenues, expenses, assets, liabilities, and contingencies. It also includes its policies for managing risk and monitoring its financial and operational performance, including budget performance and reporting on these functions, both internally and externally. Other than application of management principles to financial resources, financial management

deals with financing decisions and investment decisions (Ali and Adan, 2019).

Furthermore, financial management is about identifying various sources of finance and how much needs to be raised from each of the sources. The sourcing will depend on the type of source, period of financing, cost of financing and the expected returns. Generally Accepted Accounting Principles (GAAP) is the standard framework of guidelines for financial management used in any given jurisdiction. It includes the standards, conventions and rules that accountants

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follow in recording and summarizing and in the preparation of financial statements (Desta, Kenenisa, and Woldemichael, 2018). This term is also used as a general measure of a firm's overall financial health over a given period of time, and can be used to compare similar firms across the same industry or to compare industries or sectors in aggregation (Mills, 2008).

With respect to the effect of financial management practices on financial performance, Ohachosim (2014) stated that financial management practices have a very huge role to play in financial performance of an organisation by providing the basis for informed decision making. Specifically, Padachi (2016) opined that the management of working capital is important to the financial health of businesses of all sizes. This is because, first, the amounts invested in working capital are often high in proportion to the total assets employed and so it is vital that these amounts are used efficiently. Secondly, the management of working capital directly affects the liquidity and the profitability of firms and consequently their net worth. Agreeing with the view, Raheman and Nasir (2017) considered working capital management as striking a balance between the two objectives of a firm, that is, profitability and liquidity. They posited that firms must strive to maximize profits and enhance shareholders wealth but at the same time not sacrifice their liquidity which is necessary for smooth operations and most importantly, corporate survival. Thus, the benefits of having an efficient working capital management are the firms' ability to

meet its short term obligations, increased profitability and maintain adequate liquidity position in order to continue operation of the firms (Eljelly, 2014).

The firm's decision to invest funds in long-term assets is of considerable significance since they tend to influence its wealth, determine its size, set the pace and direction of its growth and affect its business risk (Ejoh, Okpa and Ibanga, 2016). The procedures for capital budgeting involve the accurate estimation of the project cost, correctly forecasting its cash flows, evaluating the associated risks, calculating the firm's cost of capital and using these to determine the present and net present values of the project, leading to improvement in financial performance. Adewale (2014) affirmed that "capital budgeting decisions are among the most important decisions made by business entities". This assertion could be seen in positive light considering the relationship which subsists between investment in capital goods and financial performance of an entity. Capital budgeting therefore addresses the question of how a company decides to make investments in additional capacity or in new products and to replace worn-out fixed assets. Capital budgeting is extremely important because the decision made involves the direction and opportunity for future growth of the organisation." Arnold and Hatzopoulos (2014) established that the effective allocation of scarce resources is a key part of long-term success. Effective allocation of scarce resources can be best achieved through a capital budgeting process. Such a process will



increase firm performance. This study, drawing from the foregoing, therefore seeks to examine the effect of financial management practices on financial performance of small and medium scale enterprises in Port Harcourt.

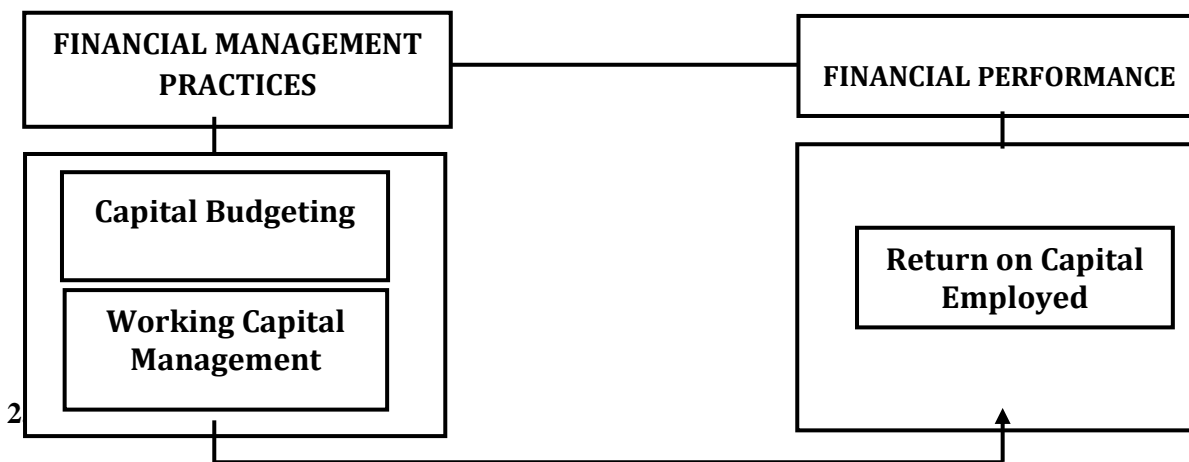
The main objective of this study is to investigate the effect of financial management practices on financial performance of small and medium scale enterprises in

Port Harcourt. The study intends to examine the following hypotheses:

H₀₁: There is no significant relationship between working capital management and return on capital employed of small and medium scale enterprises in Port Harcourt.

H₀₂: There is no significant relationship between capital budgeting and return on capital employed of small and medium scale enterprises in Port Harcourt.

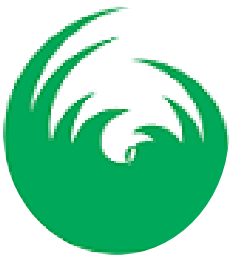
Conceptual Framework



Source: Conceptualized by the Researcher (2022)

Financial management is about identifying various sources of finance and how much needs to be raised from each of the sources. The sourcing will depend on the type of source, period of financing, cost of financing and the expected returns. Generally Accepted Accounting Principles (GAAP) is the standard framework of guidelines for financial management used in any given jurisdiction. It includes the standards, conventions and rules that accountants follow in recording and summarizing and in the preparation of

financial statements (Desta, Kenenisa, and Woldemichael, 2018). Financial management practice comprises the processes, systems, internal controls and practices relating to the way the department manages its revenues, expenses, assets, liabilities, and contingencies. It also includes its policies for managing risk and monitoring its financial and operational performance, including budget performance and reporting on these functions, both internally and externally. Other than application of management



principles to financial resources, financial management deals with financing decisions and investment decisions (Ali and Adan, 2019).

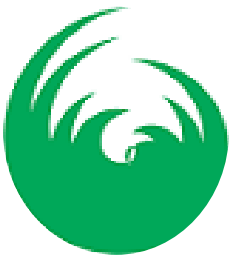
Financial management is an important element of the management of any business. It is a key part of the management function focusing on the management of a business assets (Veeraraghavan, 2018). Suitable financial management practice also plays an important role in helping service companies gain access to capital which is essential for business growth and profitability. A good financial management practice system should ensure the succeeding quantitative characteristics are met: understandability, significance, materiality, reliability, and substance over form, carefulness, completeness, comparability, suitability and an equilibrium between benefit and cost yet they continue to lack in most private service companies. According to Gitman (2000) other than application of management principles to financial resources, financial management deals with financing decisions and investment decisions. Financing decisions relate to whether a firm needs financing and how the financing will be done. Financial management is about identifying various sources of finance and how much needs to be raised from each of the sources. The sourcing will depend on the type of source, period of financing, cost of financing and the expected returns. Zuzana and Matej (2007) indicated that careless or poor financial management practice has been identified as one of the reasons for small business failures. It has also been noted that

failure to effectively discharge broad financial management Functions has contributed largely to the global financial crisis.

Working Capital Management

Working capital is an important issue during financial decision making since its being a part of investment in asset that requires appropriate financing decision (Francis, 2015). However, many authors have different perceptions about the concept “Working Capital”. Khan and Jain (2005) defined working capital as the funds locked up in materials, work in progress, finished goods, receivables, and cash and cash equivalent. Thus, they defined working capital as capital invested in current assets, which are those assets that can be converted into cash within a short period of time and the cash received is again invested into the assets. In the words of Van Horne and Wachowicz (2014) working capital represents the amount of current assets that have not been supplied by current, short term creditors. In the same vein, Chandra (2016) sees working capital as the excess of current assets that has been supplied by the long-term creditors and the stockholders. However, working capital is divided into Gross and net; Gross working capital refers to the amount of funds invested in current assets that are employed in the business process while, net working capital refers to the difference between current assets and current liabilities (Khan & Jain, 2005).

Falope and Ajilore (2009) regard working capital as the firm’s investment in short term assets. To Akinsulire

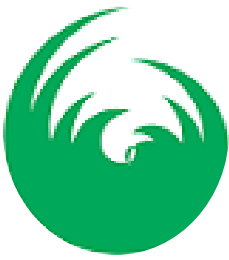


(2005) working capital is viewed as the items that are required for the day-to-day production of goods to be sold by a company. An understanding of the concept of working capital cycle will give appreciation for the study of relationship between capital and firm's performance. Weston (2008) described working capital or cash operating cycle as the total length of time required to complete the following sequence of events: Conversion of cash into raw materials, conversion of raw materials into work in progress, conversion of work in progress into finished goods, conversion of finished goods into debtors through sales and conversion of debtors into cash. Pandey (2005) also argued that working capital is a two faced concept- gross and net working capital. He defined gross working capital as the firm's investment in current assets while the net working capital is the difference between current assets and current liabilities. Net working capital can be positive or negative. It will be positive if current assets are more than current liabilities and negative when current assets are less than current liabilities. Working capital represents the current assets of a firm which is the portion of financial resources of business that changes from one type of resources to another during the day-to-day execution of business (Gitman, 2003).

Working capital means the company's current asset minus current liabilities. Keown, Martin, Petty and Scott (2005) described working capital as a company's entire investment in current assets or assets that a company anticipates to be transformed into cash within

a year or less. However, working capital management (WCM) is one of the contentious issues in short term financial management and it is key as well as tricky financial decision for any company because it has an influence on return and liquidity of a firm. Working capital management is an aspect of financial managements that seeks proper policies for managing current assets, liabilities and practically for maximizing the benefits from managing working capital. The basic purpose of managing working capital is controlling of current financial resources of a firm in such a way that a balance is created between profitability of the firm and risk associated with that profitability (Ricci & Vito, 2010). Asghar and Syed (2012) defined working capital management as decisions made in respect of current assets. Van Horne (2005) defined working capital management as the administration of current assets in the name of cash, marketable securities, receivables and staff advances, and inventories.

Working capital management in view of Paulo (2002) based on purpose of working capital ensures the effective and efficient utilization of the business's investment in fixed assets. Vineet and Sukhdev (2013) see working capital management from efficiency perspective and can be measured and achieved through the cash conversion efficiency, days operating cycle and days working capital. According to Adamu and Hussaini (2015) working capital management has to do with the administration of all aspects of current assets, namely cash, marketable securities, stock and current



liabilities. It is the functional area of finance that covers all the current accounts of the firm. It is concerned with the adequacy of current assets as well as the level of risk posed by current liabilities. Working capital management is an aspect of financial managements that seeks proper policies for managing current assets, liabilities and practically for maximizing the benefits from managing working capital. Working capital management is the management of investments or divestment in current assets and increase or decrease in current liabilities. It entails short-term decisions generally relating to the next one year period (Nwude, 2012). Working capital management involves the determination of optimum level of working capital to keep monitoring and controlling the level of individual component of working capital (Akinsulire, 2011).

Brigham and Daves (2002) noted that working capital management involves both setting working capital policy and carrying out that policy in day-to-day operations. It also involves making appropriate investments in cash, marketable securities, receivables, and inventories as well as the level and mix of short-term financing (Emery, Finnerty and Stowe 2014). In essence working capital management seeks to maintain an optimum balance of each working capital component thereby ensuring that firms operate with sufficient fund (cash flows) that will service their long term debt and satisfy both maturing short term obligation and upcoming operational expenses. Therefore, this study considers working capital management as the efficient

administration of the working capital components in such a manner that a trade-off is achieved between liquidity and profitability and the firm value is improved.

Capital Budgeting

Capital budgeting is defined according to ICAN (2006) as the firm's decision to invest its current funds most efficiently in long term activities in anticipation of an expected flow of the future benefits over a series of years. It is the process of planning expenditure on assets whose returns are expected to extend beyond one year. According to Hilton (2014) capital budgeting is, "the decision making process by which firms evaluate the purchase of major fixed assets, including buildings, machinery and equipment. It also covers decisions to acquire other firms' common stock or groups of assets that can be used to conduct an on-going business". Capital budgeting as described here involves the formal planning process to invest the company's capital in the procurement of fixed assets, or otherwise in the buying-up of an existing business (company) or its fixed assets, purposefully to enhance the viability of the investing company through enhanced business activities. Warren and Fess (2006) defined capital budgeting as 'the process by which management plans, evaluates and controls capital expenditure decisions'. They stated further that it maximizes the profit base of a company when handled proficiently and may lead to liquidation problem when neglected. The implication is that the management and control of capital budgeting to a very



large extent determines the company's viability and survival or otherwise, its failure.

According to Philippalys (2013) capital budgeting is concerned with the allocation of firm's scarce financial resources among the available market opportunities. The consideration of investment opportunities involves comparison of expected future streams of earnings from a project with immediate and subsequent streams of expenditure on it. This assertion presupposes that capital budgeting consists of the planning and development of available capital for the purposes of maximizing the long-term profitability of the company.

The basic features of capital budgeting according to Pandey (2006) include potentially large anticipated benefits; a relatively high degree of risk; and a relatively long time period between initial outlay and anticipated returns. Capital budgeting refers to the total processes of generating, evaluating, selecting and following-up on capital expenditure alternatives. The company allocates and budgets financial resources to new investment proposal. It is unlike investing in stocks and bonds, where one is required to approach the securities market and based on established forecast, invest. A company has to be proactive while investing in capital assets since it has to take the very first step of planning for such asset acquisition (Brigham and Weston, 2002).

Pandey (2004) points out those investment decisions of the firm are commonly referred to a capital budgeting or capital expenditure. He defined capital budgeting as:

The firm's decision to invest its current funds most efficiently in long-term activities in anticipation of an expected flow of future benefits over a series of years. Warren and Febb (2016) define capital budgeting as: The process, by which management plans, evaluates and controls such investment. The investment they referred to is that relating to acquisition of fixed assets. Investment in fixed assets has a long-term gestation period from the conceptual stage to when it starts to earn some stream of cash flows. Such investment should be capable of earning a reasonable rate of return, so that the business can meet its obligations to providers of capital and provide dividends to shareholders. Hampton (2017) defined capital budgeting as: The decision making process by which firms evaluates the purchase of major fixed assets, including buildings, machinery and equipment.

Financial Performance

Performance refers to the assessment of progress, at different organizational levels, toward achieving predetermined goals (Bourne et al., 2003). Performance is described as the net result of the combined efforts of all individuals and groups in the organization. It is what the organization as a collectivity of management and employees succeed in achieving. Moreover, performance is the success in meeting pre-defined objectives, targets and goals. Corporate performance comprises the actual output or results of an organization as measured against its intended outputs (or goals and objectives). According to Richard (2009) performance



encompasses three specific areas of firm outcomes: financial performance (profits, return on assets, return on investment, etc.); product market performance (sales, efficiency, effectiveness, market share, e.t.c); and shareholder return (total shareholder return, economic value added, customer service, efficiency, effectiveness, e.t.c).

However, the subject of financial performance has received significant attention from scholars in the various areas of business and strategic management. It has also been the primary concern of business practitioners in all types of organizations since financial performance has implications on an organization's health and ultimately its survival. Financial performance is one of the most important constructs in accounting research and without a doubt the singularly most important measure of the success of a commercial enterprise. Financial performance refers to the degree to which financial objectives are being or has been accomplished. Financial performance can be defined as a subjective measure of how well a firm can use assets from its primary mode of business and generate revenues (Mills, 2008). The performance measurement concept indicates that employees can increase the value of the firm by; increasing the size of a firm's future cash flows, by accelerating the receipt of those cash flows, or by making them more certain or less risky (Cadbury, 2002). There are many different ways to measure financial, but all measures should be taken in aggregation. Some of the indicators of financial

performance are return on equity, liquidity ratios, asset management ratios, profitability ratios, leverage ratios and market value ratios. Carreta and Farina (2010) argue that use of financial performance could still be justified on the grounds that it reflects what managers actually consider to be financial performance and, even if this is a mixture of various indicators like accounting profits, productivity, and cash flow. Financial performance is determined by the following indicators; profit or value added; sales, fees, budget; costs or expenditure and stock market indicators (e.g. share price) and autonomy. In this study we measured financial performance using:

Return on Capital Employed

Return on capital employed is an accounting ratio used in finance, valuation, and accounting. It is a useful measure for comparing the relative profitability of companies after taking into account the amount of capital used. Return on Capital Employed (ROCE), a profitability ratio, measures how efficiently a company is using its capital to generate profits. The return on capital employed metric is considered one of the best profitability ratios and is commonly used by investors to determine whether a company is suitable to invest in or not (Brigham and Daves, 2002). Return on capital employed or ROCE is a profitability ratio that measures how efficiently a company can generate profits from its capital employed by comparing net operating profit to capital employed. In other words, return on capital employed shows investors how many naira in profits



each naira of capital employed generates. Return on capital employed is a long-term profitability ratio because it shows how effectively assets are performing while taking into consideration long-term financing. This is why return on capital employed is a more useful ratio than return on equity to evaluate the longevity of a company. This ratio is based on two important calculations: operating profit and capital employed (Pandey, 2010). Capital employed is a fairly convoluted term because it can be used to refer to many different financial ratios. Most often capital employed refers to the total assets of a company less all current liabilities. This could also be looked at as stockholders' equity less long-term liabilities (Madura, 2015).

Ali and Adan (2019) examined the effect of the financial management practice on the financial performance services companies in Somalia. This study viewed the effect of financial management practice of all the mechanisms of financial management those were specifically; working capital, investment decision and financial decision of the services companies in the Mogadishu area. The study employed explanatory and descriptive research design. A sample of 145 respondents was selected using the stratified sampling technique. The data collected through a cross sectional questionnaire. The findings discovered that Working capital, investment decision, are significant determinants of financial performance of the services companies in Somalia. The findings indicated that the most important variable in the model was investment

decision ($\beta = 0.544$). This was followed by working capital management ($\beta = 0.419$), while financial decisions were ($\beta = -0.010$), these showed rejected. The study, therefore, recommended that services companies in Mogadishu needed to have Working capital management policy and investment decision policy which were impacted positively on the overall financial performance.

Abdul and Abdul (2018) examined financial management practices among entrepreneurial Small and Medium Enterprises in Yenagoa, Bayelsa State, Nigeria. The target population of the study is made up of the SMEs in the aforementioned state. This research used random and stratified sampling techniques. Also, the study employed quantitative research methods which were carried out using questionnaires accompanied by personal interviews. Thus, the data was analysed using the statistical package for social sciences (SPSS) using descriptive statistical analysis, independent– samples t-test, paired-sample t-test and Pearson Correlation. The research found that a significant proportion of the respondents do not have a finance officer even though an equally significant proportion of the respondents engaged in planning, recording keeping of profits, expenses and losses. Additionally, the results revealed a significant negative relationship between light credit standards and sales ($R = -0.129$, $P = p < 0.01$). On the strengths of the findings, therefore, the study concluded that chief accounting officers (accountants) are not responsible for preparing



the financial statements and that entrepreneurs are the major decision makers when giving out credits.

Desta, Kenenisa and Woldemichael (2018) examined the effect of financial management practices on profitability of small-scale enterprise in Hawassa City Administration. Questionnaires were used to collect primary data while secondary data were collected from various documents. The survey involves 116 Small-Scale Enterprise for empirical examination of fixed asset management practice, accounting information systems practice, capital budgeting management practice, working capital management practice and capital structure management practice of Small-scale enterprises. Descriptive, correlation and regression analysis were used to analyze the data. Results revealed that a good financial management practice is a backbone to Small-Scale enterprises profitability, success and expansion. Analytical finding revealed that, fixed asset management practices, accounting information system and financial reporting analysis, working capital management practices, and capital budgeting management practices have positive

relationship with profitability; but capital structure management practices has negative relationship with profitability. Accordingly, policy maker are recommended to design supportive policy to small scale enterprises as far as the variables are concerned.

3. Methodology

Survey research design will be used to describe some phenomena because it aids in gathering, summarizing, presenting and interpreting information for the purpose of clarification. It will also create room for gathering large amounts of data from a sizeable population in a cost-effective way.

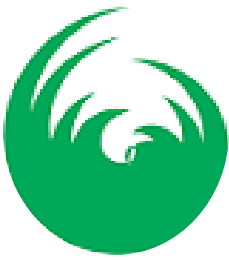
This study adopts purposive sampling technique. Purposive sampling technique is a type of non-probability sampling that is most effective when one needs to study a certain cultural domain with knowledgeable experts within.

4. Data Presentation, Analysis and Discussion of Findings

Ho₁: There is no significant relationship between working capital management and return on capital employed of small and medium scale enterprises in Port Harcourt.

Table 1. Analysis of Working Capital Management and Return on Capital Employed

		Working Capital Management	Return on Capital Employed
Working Capital Management	Pearson Correlation	1.000	.729**
	Sig. (2-tailed)	.	.000
	N	50	50
Return on Capital Employed	Pearson Correlation	.729**	1.000
	Sig. (2-tailed)	.000	.
	N	50	50



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

Source: *Field Survey (SPSS Output), 2022.*

Table 1. above reveals that there is a positive relationship between working capital management and return on capital employed of small and medium scale enterprises in Port Harcourt. This is because the correlation coefficient (r) is positive and greater than 0.50 i.e. $r=0.729$. Also, since the significant value (*p-value*) of 0.000 is less than *alpha value* of 0.05, we therefore reject the null hypothesis two (H_{02}) and accept

alternate hypothesis two (H_{A2}). The conclusion is that there is a significant relationship between working capital management and return on capital employed of small and medium scale enterprises in Port Harcourt.

H₀₂: There is no significant relationship between capital budgeting and return on capital employed of small and medium scale enterprises in Port Harcourt.

Table 2. Analysis of Capital Budgeting and Return on Capital Employed

		Capital Budgeting	Return on Capital Employed
Capital Budgeting	Pearson Correlation	1.000	.790**
	Sig. (2-tailed)	.	.000
	N	50	50
Return on Capital Employed	Pearson Correlation	.790**	1.000
	Sig. (2-tailed)	.000	.
	N	50	50

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

Source: *Field Survey (SPSS Output), 2022.*

Table 2. above reveals that there is a positive relationship between capital budgeting and return on capital employed of small and medium scale enterprises in Port Harcourt. This is because the correlation coefficient (r) is positive and greater than 0.50 i.e. $r=0.790$. Also, since the significant value (*p-value*) of 0.000 is less than *alpha value* of 0.05, we therefore reject the null hypothesis four (H_{04}) and accept alternate hypothesis four (H_{A4}). The conclusion is that there is a significant relationship between capital budgeting and

return on capital employed of small and medium scale enterprises in Port Harcourt.

Discussion of Findings

working capital management and return on capital employed, the hypothesis stated that there is no significant relationship between working capital management and return on capital employed of small and medium scale enterprises in Port Harcourt. The null hypothesis was tested at 5% level of significance. The result showed the probability value to be 0.000 while the alpha value was 0.05. Following the decision rule,



the null hypothesis two was rejected. This means that there is a positive and significant relationship between working capital management and return on capital employed of small and medium scale enterprises in Port Harcourt. This finding is supported by the findings of Veeraraghavan (2018) which indicate that good working capital practices such as effective management of cash conversion cycle and all its major components such as days in inventory, day's sales outstanding and creditors payment period are closely linked to the firms' financial performance as measured by return on asset, net profit margin and earnings per share. That is, an effective working capital management leads to an enhanced financial performance of the firms.

capital budgeting and return on capital employed, the hypothesis stated that there is a significant relationship between capital budgeting and return on capital employed of small and medium scale enterprises in Port Harcourt. The null hypothesis was tested at 5% level of significance. The result showed the probability value to be 0.000 while the alpha value was 0.05. Following the decision rule, the null hypothesis was rejected. This means that there is a positive and significant relationship between capital budgeting and return on capital employed of small and medium scale enterprises in Port Harcourt. This finding is in conformity with that of Abanis, Arthur and Derick (2013) which stated that capital budgeting is positively and significantly related to return on asset of small and medium enterprises.

5. Conclusion and Recommendations

This study has examined the effect of financial management practices on financial performance of small and medium scale enterprises in Port Harcourt. The result of the study showed that the dimensions of financial management practices adopted in this study (i.e. working capital management and capital budgeting) have significant positive effects on return on capital employed of small and medium scale enterprises in Port Harcourt. Based on the findings, the study concludes that financial performance of small and medium scale enterprises in Port Harcourt has been positively and significantly improved by financial management practices.

Deriving from the findings of this study, the researcher recommends as follows:

1. Small and medium scale enterprises should embrace financial literacy, financial information and financial management skills to effect optimal performance.
2. Small and medium scale enterprises should evaluate the viability of new projects including new products launch in terms of their profitability. The projects or products which promises good returns should be undertaken first. This way projects or products shall be ranked accordingly with projects or products with low returns being undertaken last or not undertaken at all.
3. Also, managers of small and medium scale enterprises should ensure the use of discounted



capital budgeting techniques, and allow financial managers free hand in investment/project evaluation and selection.

4. Small and medium scale enterprises should reduce the amount held in cash as current asset and concentrate more in investing them, so that it could yield higher return rather than tie down the idle cash. If this is done, it will go a long way in improving their financial performance.

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