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Financial Management Practices of Small Firms in Nigeria: Emerging Tasks for the Accountant

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Abstract

The exploratory research design was adopted to determine whether the financial management practices of small firms in Nigeria impacted on their profitability, growth and survival. Five independent variables (accounting systems, financial management information, working capital management, budgeting practices and managerial planning) were used in the evaluation which was restricted to six small firms. Results indicate that two financial information variables (accounting system and financial management information) alone dominate the risk perception of fund providers. As a result, small firms find it difficult to source adequate funds for business operations. The study also reveals that the five independent variables have significant impact on the survival, growth and profitability of small firms. SME firms are therefore advised to employ the services of qualified accountants in order to upgrade their financial management practices to enhance their overall performance.

Key words: Financial management, Small firms, Accountant, Performance and Nigeria economic development.

1.0 Introduction

Small firms play vital roles in the process of industrialization, sustainable economic growth (Ariyo, 2005); encouragement of entrepreneurship, employment generation (Ogujiuba et al, 2004); reduction of poverty and contribution to the Gross Domestic Products (GDP) of many countries (Taiwo, Ayodeji and Yusuf 2012; Audretch, 2010; Paul, 2009; Rogers, 2002). They perform such vital roles through innovation and the production of various goods and services which empower the process of economic development. For small firms to carry out such important tasks, they need credit facilities in terms of short and long-term loans.

The process of sourcing such funds as well as the effective utilization and efficient management of the funds constitute major challenges for the accountants of SMEs. The challenges require the involvement of well trained/professional accountants which SMEs lack the resources to attract. The role of the accountants in SMEs is often broader than the conventional definition of the accounting function. Apart from the basic accounting functions of providing the accounting information, auditing, tax matters, the SMEs accountant is responsible for providing general leadership in all aspects of financial decision making like working capital management, budgeting and financial planning. It has been noted that the failure to effectively discharge these broad financial management functions have contributed largely to global financial crisis (Osisioma, 2010). Similarly careless or poor financial management practice has been identified as one of the reasons for small business failures (McMahon and Holmes, 1991; Berryman, 1983). As revealed long ago by Potts (1977:2) the clearest and most startling distinction between successful and failed small businesses lie in their approach to the generation and utilization of accounting information.

Over the years, there has been a significant increase in government efforts to promote the financing of businesses by initiating policies which help small and medium scale businesses to source funds for business operations. Nigerian banks can access loanable funds from government and international financing institutions like the World Bank which uses the Central Bank of Nigeria (CBN) as the arrow head for on-lending to small businesses (Terungwa, 2012; Olorunshola, 2003; Anyanwu, 2002). In spite of the various sources of fund made available to them, accessibility to both short-term and long-term credits from banks has not been easy for SMEs because of the poor risk perception which fund providers have of small firms. The poor risk perception can be reduced if quantitative and qualitative financial information details of firms can be ascertained, adequate collaterals provided and effective banking relationships established (Okafor and Onebunne, 2010).

Qualitative and quantitative financial details provide required information about the quality of a firm in terms of size, profitability and leverage levels (Merve and Niskanen, 2010); as well as asset base and sales volume (Okafor, 2007). Researchers argue that firms that excel in such variables enjoy easier access to credit at lower interest rate and lower collateral requirements (Okafor, 2007; Cole and Wolken, 1995; Ennew and Binks, 1995). Fund providers could be reluctant to provide loans even if they are available, where there is absence or incomplete financial information to convince the lender of the financial position of the firm. Therefore, the emerging tasks of the accountant in small firms is not only to provide routine accounting services, but to assist the firms in accessing adequate finances at affordable cost, and to awake the consciousness of the owner manager to the need to adopt proper financial management practices to enhance the growth and profitability of a firm. The tasks could be summarized under the four headings including:

i. To ascertain the funding requirements of the firms as well as affordable mix of funds required by the firm.
ii. To ascertain if the fund needed is available in a definite financial institution at affordable cost.
iii. To communicate financial information details to fund providers as required in order to reducing risk perception of fund providers of small firms.
iv. To ensure that funds are managed properly by applying proper financial management techniques in vital areas as investment decisions, capital budgeting, and working capital management.

The objective of this paper is therefore, to identify and highlight trends in financial management practices of small firms, which will assist the accountants in Nigeria in understanding the financial environment in which small firms operate and their required contributions in carrying out financial management functions.

2.0 Theoretical and Empirical Background (Issues?)

It is a maxim in the basic theory of business finance that the operating characteristics of firms have important impact on their ability to raise capital (Okafor, 2007). Factors such as availability of capital, type of business, ownership structure can affect the sources and amount of capital requirement (Auken, 2001; Aug, 1991 and 1992). Firm characteristic also affect operating performance (Okafor and Ani, 2012), which in turn affects accessibility to funds (Okafor, 2007).

Experience has also shown that a firm`s search for capital starts with the identification of the nature and mix of the operational and capital needs of the firm relative to the investment preferences of capital funds providers (Tagoe et al, 2005). According to Auken (2001) the key considerations of fund providers include the type of the firm to be financed, tenor of the financing, expected return on the investment, growth potentials of the firm and its risk management track record.

Banks extend credit facilities to businesses ranging from short-term overdraft facilities to medium and long-term loans and advances. But whatsoever the type, access to bank facilities depends on ability to provide adequate quantitative and qualitative financial information about the past and current operations as well as a well articulated future plans of the business to support loan requests (Mumbula, 2002). The services of an accountant are therefore required to package loan proposals whether such services are rendered on full time or part timed basis.

Empirical studies carried out on financial management practices of small businesses in developed countries, have thrown up two important pieces of information namely that the quality of management accounting information utilized within a small business organization has a positive relationship with the entity`s performance; and that significant efforts and progress have been made in encouraging SME owner-managers to install and apply accounting information systems (McMahon and Holmes, 1991). The availability of affordable computer software has played an important role in improving the accounting information systems of SMEs. Many operational accounting functions of SMEs like payroll accounting, preparation of accounts receivables and payables, general ledger, sales analysis and inventory are now computer aided. The availability of computerized accounting systems has not only improved the standard of financial reporting in small businesses but has also shortened the time required by firms to produce summary information in the form of balance sheets, income statements, funds statements, bank reconciliation and operating summaries. However, the actual application of financial reports by owner-managers is hampered by the inability of a majority of them to correctly interpret such reports and utilize them in managerial decision making.

Recent and old financial management literatures targeted on small enterprise owner-managers emphasize the importance of developing skills in reading and interpreting financial statements to monitor the financial health and progress of firms (Cole, and Wolken, 1995; Konstans and Martin, 1982; McMahon, 1986; Meredith, 1986; Walker and Petty, 1986; Barrow, 1988). Benefits of the use of quality financial statements abound. Evidence abroad; for instance, indicate that they help to provide break-down of cost of a firm on a frequent or regular basis as well as help to maintain up-to-date figures on contribution to profit of individual products or product lines (McMahon and Davies, 1994). It can also help in comparing a firm's performance with industry figures. Effective use of financial ratio analysis in managerial evaluation, planning and decision making can increase business profitability, growth and survival (McMahon and Holmes, 1991).

Another aspect of financial management practice which creates problems for small firms is working capital management. Working capital is necessary for carrying out the day-to-day operations of a firm. It is defined as current assets less current liabilities, which involves the maintenance of proper balance in the management of cash, debtors, stock and creditors. Cash management techniques, includes formal methods like fixed percentage of sales, purchases, or expenses as well as naïve practices for detecting aging overdue accounts and enforcing the application of credit checking systems.

Very few firms apply quantitative techniques such as "economic order quantity" in optimizing inventory levels and many businesses rely on accounting systems which do not provide information on inventory turnover, reorder level, ordering costs and carrying costs.

3.0 State of Practice in Nigeria

Most owner-managers in Nigeria perceive their businesses as their private affairs and therefore do not accept any responsibility to be accountable to any one or to be transparent in their operations. Such a mind set is counterproductive and ill conceived because most of such businesses depend on funds sourced from public institutions. Some of them even feel that the services of qualified accountants can be dispensed with. They don`t know that the accountants job entails much more than the keeping of accounting records. The task of an accountant starts with the designing of accounting systems suited to the needs and peculiarities of the particular business. Thereafter, the accountant`s task stretches to the capturing of business transactions, in proper and relevant books of accounts. The follow-up jobs which are more fundamental to the survival and performance of the business include financial decision making involving financing decisions, working capital management, budgeting processes and planning. Due to the low level of accounting expertise available to small businesses key components of these accounting responsibilities are completely ignored, down played or improperly discharged in the organizations.

A survey was carried out on six SMEs in South East Nigeria to ascertain the level of attention paid to each component of these key accounting functions in the firms. The six firms selected for the survey included two manufacturing firms, two service providers and two marketing companies. Five broad categories of accounting functions were selected for the survey including presence of budgeting practice, well defined accounting system, financial reporting, application of sound working capital practices, adherence to orthodox budgeting practice and managerial planning. Each of these functional areas was further sub divided for the purpose of the survey.

The five point likert scale of values was applied to ascertain the relative level of attention paid to each of the disaggregated accounting functions in the firms. The scores were as follows: 1 = poor, 2 = fair, 3 = good, 4 = very good, 5 = excellent. The outcome of the value scoring with respect to the sampled firms studied is presented in table 1 as indicated below.

Table 1: Scale of Application of Selected Financial Management Practices on Sampled Nigerian Firms

Independent Variables	F1	F2	F3	F4	F5	F6	AV	M(A)
(i) Accounting Systems:								3.28
Financial records	5	5	5	5	5	5	5.00	
Computer utilization	2	1	2	3	2	3	2.66	
Cost accounting system	2	2	2	3	3	3	2.5	
(ii) Financial Management Information:								2.44
Utilization of financial statements	2	2	2	4	3	4	2.83	
Extent of financial ratios in use	2	2	2	3	2	3	2.33	

Quality of Techniques in use	1	2	2	3	2	3	2.16	
(iii) Working Capital Management Practices								2.03
Management of cash	3	3	4	4	4	4	3.66	
Management of accounts receivable/Payable	1	2	1	2	2	2	1.66	
Management of Inventory	2	2	1	2	2	2	2.5	
Computer based working capital management	1	1	1	2	1	2	1.33	
(iv) Budgeting Practices								1.69
Capital budget	2	2	2	3	2	2	2.33	
Operational budget	1	2	2	3	3	3	2.33	
Sales budget	2	3	2	4	2	4	2.83	
Cash budget	2	2	2	3	2	3	2.33	
Production budget	1	1	1	2	2	2	1.5	
Profit budget	1	-	-	2	2	2	1.16	
(v) Managerial Planning								2.11
Setting financial objectives	2	2	3	2	3	3	2.5	
Inventory planning	3	3	3	4	3	4	3.33	
Marketing planning	3	3	2	3	3	3	2.83	
Personnel planning	1	1	1	2	1	2	1.33	
Pricing practices	2	2	2	3	2	3	2.33	
Performance evaluation	-	-	-	1	-	1	0.33	
Average for the five independent variables								2.31

Source: Survey data 2012

Note:

F1 – F6 =Identification codes for the firms in the sample

M/A = Mean average

In summary, the average scale score of each of the five components of financial management practices was (3.28) for accounting systems, (2.44) for financial management information, (2.03) for working capital management practices, (1.69) for budgeting practices and (2.11) for managerial planning. The table indicates that it is only the area of financial records and accounting systems that the firms scored above the average. The lowest score was budgeting practice (1.69) which is far below the average. The average scale score on all the financial management components (2.31) clearly indicates a sub-optimal performance in accounting and financial management functions in the sampled establishments.

Evaluation

Before carrying out a more rigorous evaluation of the outcome of the survey, it is important to restate the two main issues in contention in this exploratory study. The first issue is the relationship if any between the level of success in the discharge of five key accounting and financial management functions in small scale businesses and the investment risk perception of fund suppliers to such businesses. The second issue, which is closely related to the first, is the relationship, if any, between success in the effective discharge of those functions and the overall performance of the businesses in terms of profitability, growth and survival.

Hypotheses

The two basic issues could be restated as two basic hypotheses in the null form.

1. The quality attained in the discharge of the key accounting and financial management information functions in small scale businesses does not affect the investment risk perception of fund suppliers to such businesses.
2. Success in the effective discharge of the five key accounting and financial management functions does not affect the overall performance of the firms in terms of profitability, growth and survival.

Since it was not feasible to quantify the key components of accounting functions specified in the study (see table 1) the five likert scale of values derived for each function in the survey were applied in testing the relationships hypothesized. The Kruskal-Wellis statistical test technique was adopted in conducting the test of relationships specified in the hypotheses.

The formula for this statistical analytical tool is stated as follows:

$$\text{H statistics} = \frac{12}{N(N+1)} \sum \frac{R^2}{n} - 3(N+1)$$

Where: H = Result of the test Statistics

N = number of ranked scores in all independent variables combined

n = number of cases in each individual sample (independent variables)

R^2 = the sum of ranks for each individual sample (independent variables)

The H statistic is tested using the chi-square distribution with the five groups, df = 4, Therefore, the process involved testing H against the critical value of 18.47@ .001 in which H must be greater than or equal to x^2 (critical value) to be considered significant. The assumed level of significance for all the tests was 5% and 1%

Test of hypothesis one:

This hypothesis was tested by applying the Chi-square test at 5% level of significance.

$$X^2 = \frac{\sum(0i - Ei)^2}{Ei}$$

Table 2: Impact of Accounting and Financial Management Information Functions on the Risk Perception of Fund Suppliers

Variables	Important	Not very Important	
Accounting Functions	.5	0 - 2.5	RT 6
Financial Management Functions	0 - .5	3 - 2.5	RT 6
	1CT	3CT	GT 12

Source: Survey data 2012

Based on the relative responses in table 2, the relevant chi-square test result is derived as follows:

$$\frac{(1-.5)^2}{.5} + \frac{(2-2.5)^2}{2.5} + \frac{(0-.5)^2}{.5} + \frac{(3-2.5)^2}{2.5}$$

$$0.5 + 0.1 + 0.5 + 0.1 = 1.11$$

The critical value for this test is also derived as follows:

Critical value = $(.05)x^2(1) = 3.84$

Since the test statistics (1.11) is less than the critical value (3.84) the null hypothesis is accepted. Therefore, financial information variables (accounting functions and financial management functions) alone have no significant effect on the risk perceptions of fund suppliers to small firms. This seems to contradict the findings in an existing study by Okafor and Onebunne (2010) that management information skills, banking relationships and collateral together can reduce risk perception of fund providers to small firms.

Test of Hypothesis Two:

This hypothesis tries to ascertain the impact of the discharge of accounting and financial management functions on the overall performance of small firms as proxied by profitability, growth and survival of such firms.

Kruskal – Wallis one Way Test Analysis is used.

The first step was to combine data of all the accounting and financial management functional areas as indicated in Table 3

Table 3: One Way Test Analysis of the Impact of Functional Variables on Firm Profitability

Accounting Systems Functions		Financial Management Information Functions		Working Capital Functions		Budgeting Practices Functions		Managerial Planning Functions	
Changes in scores	Rank	Changes in score	Rank	Changes in score	Rank	Changes in score	Rank	Changes in score	Rank
5	6	4	2	4	4	4	2	4	2
4	2	3	5	3	5	3	8	3	14
3	4	2	10	2	7	2	19	2	10
2	5	1	1	1	8	1	4	1	6
1	1					-	3	-	4
R^2	18		18		24		36		36
n	5		4		4		5		5
R	3.6		2.5		6		7.2		7.2

Result at 0.001 level of significance

Source: Kruskal-Wallis one way test analysis

$$\text{H statistics} = \frac{12}{N(N+1)} \quad \sum \frac{R^2}{n} - 3(N+1)$$

Result:

N = 23

n = Accounting systems (5), Financial management information (4), Working capital management (4), Budgeting practice (5), Managerial planning (5)

R^2 = $18^2 + 18^2 + 24^2 + 36^2 + 36^2$

Df = 4

By derivation from the above, the test statistic is 54.45 while the critical value (18.47) for df = 4, at 0.001

Since the test statistics (54.45) is greater than the critical value (18.47) at the derived df = 4 at the 1% level of significance the null hypothesis is rejected. By implication, the degree of effectiveness in the discharge of the accounting and financial management functions in small business enterprises impact positively and significantly on the overall performance of such businesses in Nigeria.

5.0 Discussion

Overall the available evidence suggests that the application of financial management techniques remains inadequate in most of the small firms in Nigeria. Many owner managers of small firms believe that the methods of financial management and capital budgeting practices that apply in developed countries would not work well in this country because the economic and social environments of developed countries are substantially different from that of Nigeria. Again, most business owners are not sufficiently exposed to modern quantitative financial management techniques and therefore cannot apply them in financing and capital budgeting decisions. Important decisions like the purchase of equipment or expansion of facilities are based more on intuition, instinct and past experience than on scientific evaluation. In most situations, the issue of survival is often the top priority concern of the small businesses. Long-term strategic approaches to financing and capital expenditure decisions are hardly contemplated. The short-term approach makes them to finance capital projects using loans from friends and families, or short term bank loans with the high interest rate.

Small businesses have very much limited internal (in house) capacity to handle the key accounting and financial management functions. Their counterpart in developed countries could experience similar staff limitations but can easily outsource the services to part-time consultants in large small business consulting services markets which exist in advanced economies Overall, the discharge of accounting and financial management functions in small businesses in Nigeria is very much limited. It concentrates on the generation of basic financial operational data without providing the follow-up analysis to guide financing and investment decisions. This serious limitation impacts negatively on the performance of the firms and account for the high incidence of slow growth and high failure rate among the firms.

6.0 Conclusion

The importance of financial information cannot be overemphasized. Firms face increasing pressure from banks and other fund providers as well as economy regulators to provide all sorts of financial information about their operations. A number of factors inhibit the preparation and presentation of financial information by small businesses. Such factors include lack of qualified staff and the inability of owner managers to appreciate the right of stakeholders to have access to such information. Again many firms find it expensive to maintain the services of qualified accountants to provide such information. Some other firms are apprehensive that divulging much accounting information about their operations would expose them to higher tax liabilities..

Evidence available in this study suggests that the state of accounting and financial management practice remains inadequate among small businesses in Nigeria. This raises doubts about the effectiveness of the growing number of well educated and professionally qualified accountants that are turned out yearly by institutions of higher learning in Nigeria. It also calls to question the enormous resources channeled into programmes for small business empowerment by governments in Nigeria.

Owners of small businesses should recognize the fact that no business enterprise, irrespective of its size and field of operations, can survive and perform optimally if its` accounting and financial management functions are not handled by competent and capable hands. Such functions would be best performed if competent and qualified staff can be hired and retained in-house for that purpose. Where it is not feasible to secure and retain full time staff of the right caliber, then the services could be out-sourced to qualified small business consulting firms to provide them on part-time basis.

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